The Rights of
MARGIN CUSTOMERS
Against Wrongdoing Stockbrokers
and some other problems in
The Modern Law of Pledge

By

EDWARD H. WARREN

A.B. Harvard, 1895, A.M. Columbia, 1896, LL.B. Harvard, 1900; a member of the Harvard Law Faculty from 1904 to 1929, and from 1934 to date; practised law in New York City from 1900 to 1904, and in Boston from 1908 to 1921 and has since, on occasion, been of counsel; author of Cases on Property (second edition, 1938), Cases on Corporations (second edition, 1916), the exposition of the Rule against Perpetuities in the Cyclopaedia of Law, a treatise on Corporate Advantages without Incorporation, lectures delivered at various English and Scottish Universities, 1930–33, and various contributions to American and Canadian legal periodicals.

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TO ELINOR, MY WIFE,

WITHOUT WHOSE DEVOTED CARE

THIS BOOK WOULD NEVER HAVE BEEN WRITTEN

PREFACE

In the first chapter, some things have been said that might have been said in a preface. Therefore the preface will be confined to some suggestions about style, and to the acknowledgments which are due to others.

Style. I note with deep and increasing regret that some jurists on the bench and many jurists off the bench evidence no instinct for simplicity and terseness of expression. They clothe their thoughts with a prodigality of drapery which ought to be as repulsive to the wholesome-minded as the rich plush which some decades ago was regarded as *le dernier cri* in the very best railroad, steamship, and hotel circles.

Some of these jurists must have been born with a long spoon in the mouth. They make four words grow where only one word grew before, and rejoice that it has been given to them to add to the national wealth. Some of them even invent new nomenclatures, juristic Mumbo Jumbo, words which are unintelligible, without explanation, to intelligent laymen. They build themselves stilts and thump about making loud noises, and are exceeding glad that they have grown to giant size, and ever and anon duck a low star.

How to correct this? If a student asks my advice, I say to him:

1. Never dictate anything which calls for careful thinking. Write out everything (except quotations) in longhand. If you dictate you are likely to get into a habit of using words of many syllables like " formulated " or " constituted." If you write in longhand you are likely to get into a habit of using words of one syllable like " made " or " was."

2. Make it a habit of life to spend ten minutes a day in reading something in the Psalms or Proverbs or Gospels; and treasure

the short, terse, depicting, dynamic, devastating words and expressions.

3. See to it that not less than sixty-six per cent of your words are words of one syllable, and that not less than eighty-three per cent are words of one or two syllables.

4. Go over the drafts as they come back from the typist and rub and rub and rub again until you have massaged away every muddy word and every waste word.

5. If you are dealing with a tough juristic topic, lighten the strain from time to time. If one page has to contain a headache, balance it with another page that contains a smile. A joke may be the most effective of arguments, and the most dignified dignity is an unstilted dignity.

6. *But* avoid being " cheap " as you would shun the plague. You are living in a picture age; picturesqueness is the order of the day. All right, adapt yourself, be picturesque; but *never* be cheap. And be keenly conscious of the fact that the line between the picturesque and the cheap is *not* a bright line.

7. Let learning be your servant, not your master; the deepest learning is the learning that conceals learning. The bread of an idea is worth more than a stone of information. Do not spread out in full your laboratory notes. Do not be *magis in operatione quam in opere*. Appraise your " productivity " not by quantity but by quality. Read much, discuss much, ponder most, write a little.

Acknowledgments. More than thirty persons have helped me in the preparation of this treatise.

Of these, Williston (p. 79) is *facile princeps*. He has given me no end of time. The written memoranda that have been exchanged make a pile more than an inch thick, and these have been supplemented by many, many talks. I have questioned him everywhere, — in his office, at his home, on the street. I have even, when playing contract with him, slipped in a question or two as a soothing spot of relief from gory post-mortems.

There is hardly one of my colleagues that I have not conferred with, or consulted, or questioned, or pestered (throw wide the

dictionary and choose your word). The law is a seamless web, and whatever else the Harvard Law Faculty is, or is not, it is certainly an intellectual beehive, without one drone.

Eldon James, our genial and resourceful librarian, has seen to it that everything that I wanted in the way of books should be available, and he guided me in the selection of the portraits of jurists. I have asked him, and he has kindly consented, to write a special preface on portraits (p. ix).

Professor Rand of the Latin Department has kept me straight on my Latin, and Professor Merriman of the History Department has done a like service with respect to Spanish history.

The treatise contains uncompromising adverse criticisms of Judge Cardozo's opinion in *Wood v. Fisk* (pp. 226–229), of certain decisions by the Supreme Judicial Court of Massachusetts, and of some of the teachings of Dean Ames upon the law of property. I put two questions to Mr. Justice Frankfurter: "Do I make any statement in criticizing Judge Cardozo's opinion which is not an accurate statement? Have I omitted any statement of fact which ought to have been made in order to give a complete picture of the facts?" I put similar questions with respect to *Pratt v. Higginson* (p. 128) and the *Raymond-Syndicate* case (p. 161) to Mr. Chief Justice Field of the Supreme Judicial Court of Massachusetts. I put similar questions with respect to my criticisms of Dean Ames to Joseph Warren, a colleague who was also my classmate in the Law School. Each of the three wrote me a carefully considered reply.

It should be clearly understood that no one of them passed upon, or even made suggestions as to, the soundness of the criticisms *or* the uncompromising form in which those criticisms are expressed. Both as to the substance and as to the form of the criticisms, the *sole* responsibility is upon me.

A last and most cordial word of thanks is due to the other three wheels of the coach, Mr. Philip A. Putnam, Mr. Robert G. Zeller and Miss Caroline M. Regan.

Mr. Putman has been a member of the Library Staff for many years, and I have found him uniformly helpful and reliable. I placed upon him, and he accepted, sole responsibility for the ac-

curacy and completeness of the citations and the tables of cases and statutes. My confidence in him is such that I did not even glance at the proofs of those tables.

Mr. Zeller (Stanford, A.B.), one of the tip-top first-year students in 1939-40, made a volume to volume search of all New York reports since 1863. In asking him to make that search, I did not turn over my own notes to him. When he reported, I found that he had every case that I had and several of which I had not known before. To get " everything " is well-nigh impossible, but I believe that after the Zeller harvesting not more than gleanings are left. He also made some helpful suggestions respecting my comments on cases in Chapter IX; that chapter is quite as much his chapter as it is mine. He also gave me much help about the Index and in seeing the book through the press.

Miss Regan (Smith, A.B.) has supplied (" supplied," not " supplemented," is the *mot juste*) the oil of patience in dealing with persons whom I have asked to do some perfectly simple thing and who have only responded with a perfectly good reason why it was not done. She has done some of the typing, has kept the numerous drafts and papers in order, has kept me uniform in expression, spelling and punctuation, and has saved me from several mistakes, the publication of some of which would have mortified me. She also gave me much help in seeing the book through the press.

The preparation of the treatise has taken about 450 hours (15 hours a week for 30 weeks). By reason of the help given by these three persons, each of whom is in his or her way an efficient person, I have been able to give at least 90 per cent of those hours to creative work.

E. H. W.

Langdell Hall
Harvard Law School
April, 1941

PREFACE AS TO PORTRAITS OF JURISTS

These are all from the collection of legal portraits in the Harvard Law School.

Sir Edward Coke, in the Proemium to his First Institute, the Commentary upon Littleton, says that "He that is desirous to see his picture, may in the Churches of Frankley and Hales Owen see the grave and reverend countenance of our Author." These portraits of de Littleton, as well as the portrait brass on his tomb in Winchester Cathedral, disappeared during the troublous days of the great Civil War. However, sketches (rather rough, to be sure) of the figures of de Littleton in the windows of the church of Frankley, where he was born, and of the church at Hales Owen, in the neighborhood, have been reproduced in the Report on the Inner Temple Pictures of Judge Littleton and Sir Edward Coke by F. A. Inderwick, Q. C., and Leonard Field.

The engraving reproduced, opposite p. 44, was made by Robert Vaughan, and apparently first appeared in the second edition of Coke's Commentary on Littleton in 1629. Unquestionably, Vaughan made use of the portraits at Frankley and Hales Owen, as may be seen from the sketches mentioned above, and perhaps also of the portrait brass on the tomb which is said to have shown de Littleton kneeling. Vaughan's engraving, therefore, notwithstanding that nearly a century and a half had passed since de Littleton's death in 1481, was based upon authentic material. The portrait of de Littleton in the Inner Temple was painted some time in the first half of the seventeenth century and may have been based upon the same materials (though there is a question as to whether it was intended to be a representation of the author of the Tenures).

The portrait of Sir Edward Coke, opposite p. 52, has been made from a small painting which is probably a very much reduced copy of part of the Inner Temple portrait by Paul van Somer, painted in 1616, which is reproduced by Inderwick and Field in the Report referred to above.

It is believed that Lord Mansfield's portrait, opposite p. 92, is here reproduced for the first time. Unquestionably, the portrait is by Sir Joshua Reynolds. It had been in the possession of a family in Baltimore continuously for more than a hundred years before its acquisition by the Harvard Law School. It bears a close relationship to the large portrait of the Chief Justice painted by Reynolds in 1776, which is familiar through Bartolozzi's famous engraving. The chair in which the Chief Justice is sitting is identical in both pictures, and the arrangement of the bands and the collar of SS is the same. The portrait here reproduced may have been a preliminary study for the larger portrait. It is not likely that it is a copy, though we know Reynolds made at least two copies, for in addition to the fact that the figure is blocked in by a vigorous freehand sketch in charcoal which may be seen when the painting is held up against a strong light, it is unfinished, in the colors Reynolds used for his under-painting, dull red, brown and white. It is hardly likely that if it were a copy it would have been left in that condition.

It may be noted that the Harvard Law School portrait is not listed by Sir Walter Armstrong in his Sir Joshua Reynolds, published in 1900, or in the very carefully prepared catalogue by Graves and Cronin in their History of the Work of Sir Joshua Reynolds, published in 1899, but it has been pronounced by the experts in the Fogg Art Museum to be indubitably a Reynolds.

The portrait of Sir William Blackstone, opposite p. 60, is reproduced from an engraving by Samuel Bellin of the portrait by Gainsborough.

The portrait of Joseph Story, opposite p. 156, has been in the possession of Harvard University for a great many years. The University tradition is that it was painted by Gilbert Stuart in 1819. If this is correct, it shows Story as he was in his fortieth year, eight years after his appointment to the Supreme Court of the United States in 1811.

The portrait of Chancellor James Kent, opposite p. 72, is reproduced with the consent of George Barmore, the son of the late Charles Barmore, from the etching by James S. King of the painting by Rembrandt Peale.

Mr. James C. Carter's portrait by Sargent, opposite p. 278, which hangs in the Harvard Club of New York, is reproduced from a photograph.

The portrait of Mr. Justice William Mitchell, of the Supreme Court of Minnesota, opposite p. 138, is reproduced from an etching, presented to the Harvard Law School by his son, Hon. William A. Mitchell, a former Attorney General of the United States.

The portrait of Judge Charles A. Rapallo, of the New York Court of Appeals, opposite p. 266, is reproduced from an original photograph.

ELDON R. JAMES

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Chapter I

WOOD v. FISK DELENDUM EST

THE author is aiming high. So high, that there will be those who think it impertinent, and there will be those who think it hopeless. He is aiming at nothing lower than those who are clothed with judiciary robes.

The respect which laymen have for the courts today is lower than it was a generation ago, and a great deal lower than it was a century ago. Many causes have contributed to produce that depressing result. We do not believe that the judges themselves are the sole cause, or even the main cause, but we do believe that they have been a contributing cause.

Some (not all) judges have been guilty of one or more of the following delinquencies: (1) Failure to recognize that the law should be *developed* in harmony with changing conditions,— that it must not be static in a world otherwise dynamic; (2) failure to recognize that legal conceptions ought, so far as it is practicable, to be harmonious with the conceptions of laymen of integrity and intelligence; (3) failure to think things out carefully, and to express themselves tersely and lucidly so that their opinions may give light and leading, may be a sun and not a fog. " What *was* he thinking about? What *did* he mean? " If an opinion rouses such questions, then it is a poor opinion, one that does not end confusion but which adds confusion and is a prolific breeder of litigation. The intelligent public have no relish for such opinions, and view those from whom have proceeded such sounds with mixed feelings, and not solely with feelings of admiration and respect.

Casting about for a topic in which there were decisions illustrating one or more of these delinquencies, we finally selected the modern law of pledge, with the topic of margin customers to hold the center of the stage, and the opinion of Judge Cardozo in *Wood v. Fisk,* decided in 1915 by the New York Court of Appeals, to hold the center of the center.

A person whom we will call A, who is usually on speculation bent, orders B, a stockbroker, to buy some shares of stock for A's account. B does so, and pays the whole purchase price to the seller. A pays B only a part; this part was usually about ten per cent in the old days, but at the present time under wise rules of the New York Stock Exchange it must be not less than thirty per cent. Precisely what is the legal relation between A and B?

One possible view is that A has *only* contractual rights, rights *in personam* (the *persona* being the stockbroker B), that B's only duty is to produce the stock purchased (or its equivalent, for shares of stock are as fungible as wheat) whenever (1) A is minded to sell so that a delivery to the purchaser may be made, or (2) A is minded to pay the balance and take up the stock as an investment. The times when the second (investment) alternative is selected are probably not more than two per cent of the times when the first (speculation) alternative is selected. The fact *almost* always is that A has a get-rich-quick urge and that he is buying because he confidently expects to sell at a higher price in the future, — and in the near future at that. Therefore, some judges have said, B's only duty is to supply the wherewithal for a delivery to a purchaser, when A is minded to sell (or to deliver to A himself upon A's discharging his debt). If this is the conception, then it logically follows that B, the broker, and not A, the customer, is the owner, — that A has no property rights, no rights *in rem,* but only contractual rights, rights *in personam,* against B, and B breaks his contract only if and when he fails to respond to A's command to produce such stock (or its equivalent) for delivery to the purchaser from A (or to A himself).

But most judges have said that A, not B, is the owner, and that B is only a *pledgee,* the stock being security to A for the payment of A's debt to B.

The first view is understandable, but the second view, we submit, is — and clearly is — the proper view. All chance of gain is with A, all risk of loss is upon A, and in many other situations the law has said that he who has the chance of gain and stands the risk of loss is the owner. Moreover, to hold A to be the owner is in accord with the conceptions of business men. We never (as

it so happens) talked with any business man who did not suppose that *of course* in such a case A, the customer, and not B, the stockbroker, was the owner. In fact, the idea that the broker is the owner strikes business men as more or less ridiculous (rather more than less) and, if they are told that this is the law in a particular jurisdiction (like Massachusetts, where this has been the law about *half* the time), they think that there is something funny about the law.

Now, there have been, and are, about ten times as many such transactions on the Stock Exchanges in New York City as on all the other Stock Exchanges in the country put together. Therefore, New York has been, and is, the natural leader in this particular topic in the law, and this has been recognized by other courts, including the Supreme Court of the United States.

Which view is to receive judicial sanction? The adoption of one view rather than the other frequently makes a lot of difference in the result of litigation.

About seventy years ago, this point was twice considered by the New York Court of Appeals in the famous cases of *Markham v. Jaudon* (p. 260) and *Baker v. Drake* (p. 276). The cases were elaborately argued by counsel who were leaders of the New York bar in their day, the point was squarely presented, the court gave the matter prolonged and most careful consideration, and both times the court was divided in opinion.

But in *both* cases the court decided, by majorities of six to two and five to two, that A was the owner, that B was only a pledgee, and that B was subject to all the duties which the common law imposed upon pledgees (in the absence of any valid agreement between A and B to the contrary). After these two arguments and decisions, that excellent judge, Judge Rapallo, although he was originally a breach-of-contract man and had held out for that view in *Baker v. Drake,* felt that it was not seemly for him any longer to press his own views, and he thereafter acquiesced in the will of the majority and unswervingly applied the rule that A had contractual rights (all courts are agreed on that, and always have been agreed on that), *and* that he *also* had *property* rights which B must scrupulously regard. For decades that was supposed to be

clear law in New York; and the courts in other American jurisdictions, excepting only Massachusetts, accepted and followed the New York lead.

Then in 1915 came Judge Cardozo's opinion in *Wood v. Fisk* (pp. 226–229). Without A's consent and without retaining in his control a like amount of like stock, B pledged A's stock to C, a bank, as part of the collateral for a loan by C to B of an amount larger than A's debt to B.

Now, do not fail to grasp the business situation. As the stockbrokerage business was then conducted, and as it is *still* conducted, few, if any, stockbrokers have sufficient capital to supply out of their own means the price of all the stocks purchased by customers, less the margins paid by customers. They *must* borrow from financial institutions, or close their doors. Stockbrokers at one time vigorously contended that therefore they had the lawful right to repledge to financial institutions, — that such repledges were something sanctioned by a custom-of-the-street which had been acted upon throughout the time of financial memory.

But also, do not fail to appreciate the risk to which this custom-of-the-street, if sanctioned by the courts, would inevitably expose the customer. The distinction is vital between first-class securities and second-class securities (p. 22). Second-class securities are those where even a bona fide purchaser or pledgee gets only *derivative* rights, — rights limited by and never exceeding the rights of B, the transferor; while first-class securities are those where a bona fide purchaser or pledgee gets *independent* rights, — rights which may be greater than the rights of B. If the security is legally second-class, C gets, not what he thought he was getting, but only, by succession, what B had, — C stands in B's shoes. But if the security is legally first-class, C gets what he thought he was getting, — C stands in his own shoes.

Therefore, if B pledges A's stock to C, a bona fide pledgee, and later B defaults, C will have a clear right forthwith to make a liquidating sale to provide proceeds out of which B's debt to C may be paid. This liquidating sale utterly destroys A's property rights in the stock, and, if B cannot meet his obligations (if B has defaulted to C he rarely if ever is able to meet his other obliga-

tions), A finds himself out on the sidewalk with *nothing but a claim against a broken broker.*

The most important point in the law of margin customers is that every margin customer is exposed to a *double* risk. Grasp that firmly. If the stock optimistically purchased falls in value, he must stand the loss. But, even if it rises in value, B may break, and A must find such consolation (if any) as he can in the depressing atmosphere of a bankruptcy court.

A speculator is born every minute. It is amazing how many speculators have not realized, and how many speculators still do not realize, that speculation through stockbrokers exposes them to this *double* risk.

The pertinent question becomes: Is an unauthorized pledge of customers' security by a stockbroker to a bank a " conversion "?

We must first see what the *common law* means by that word " conversion." It is a many-meanings word. Ordinarily, it simply connotes a change, without any connotation as to whether the change is for the better or the worse. Sometimes it is used to connote a change for the better, as when we say that the heathen are converted. But in the common law it is used with a *sinister* connotation, to connote a change for the worse. If a *person* is changed from the wrong path to the right, we say that *he* is converted, and rejoice. But if *personal property* is changed from the right path into the wrong, the common law judges say that *it* is converted, and groan.

The law of pledge and the law of conversion are inextricably intertwined. Therefore, in Chapter V, one of the foundation or background chapters, we inquire at great length precisely what the common law means by the word " conversion." Several attempts have been made to give a terse definition of a common law conversion. We are convinced that no reliable *terse* definition has ever been given, and doubt if it will ever be achieved. Our definition — a regrettably long one — is that a conversion is *that kind of tort* which is (1) a tort to some kinds of personal property, (2) by a person who has by some means lawful or unlawful come into the *possession* of such personal property, the wrongful act by such possessor being (3) a *misfeasance* (an

affirmative act) rather than a nonfeasance (a failure to do something), and (4) amounting to a *major,* serious tort rather than a minor, trifling tort (p. 117).

If this definition is reliable, then we submit that a tortious pledge by B to C, a bona fide pledgee, of stock belonging to A is *clearly* a conversion. We think that there is not room even for an intelligent difference of opinion on that, for these reasons:

(1) All courts agree that shares of stock are one of the kinds of personal property which are within the scope of conversion; (2) on the facts, B indubitably came into possession; and (3) B did an affirmative act by the transfer to C. The only question left is whether it is (4) a *major,* serious tort, or is only a minor, trifling tort. How, within the bounds of reason, can it be said that this tortious transfer which puts A's property in jeopardy and exposes him to the risk of the utter destruction of his title without any default of his own may properly be characterized as a mere minor, trifling tort?

True it is, that B *may* meet his obligation to C. The weather may continue fair, and B *may* redeem the stock from C, in which case A will suffer no loss. But ought the law to dismiss with a shrug of its shoulders this tortious act of B which exposed A to such serious risk?

If a trustee "borrows" trust funds for his own purposes, "Sing Sing" awaits him. Restoration of the *status quo ante* (if his optimism proves to be justified) does *not* absolve him from liability. Then it is not fitting that, if a stockbroker "borrows" his customer's stock to secure funds to enable him to conduct his stockbrokerage business, and "everything comes out all right," only "Tut, tut," and a judgment for six cents shall await him.

Yet that is all that does await him, if Judge Cardozo's opinion is to prevail. He said that the pledge "may have been a conversion; it was unquestionably a breach-of-contract." He characterized the tortious act as only a "technical" conversion. If B was so fortunate as to be able to redeem from C, A's damages against B should be only "nominal."

An analysis of that opinion will show that while Judge Cardozo *talked* conversion, he *reasoned* in terms of breach of con-

tract. The opinion is not a frontal attack upon the opinions of the majority in *Markham v. Jaudon* and *Baker v. Drake,* but it *is* an insidious undermining. Judge Cardozo was going back to the position of the dissenting judges in those famous cases, and saying *in effect* that A had *only* contractual rights. The results of decades of good, hard juristic work were shaken to their foundations, and what the New York law is today on tortious pledges by stockbrokers of securities purchased for the account of customers no man knows.

There is a temple dedicated to the worship of a Janus-faced God. The left-side face is a conversion face. The right-side face is a breach-of-contract face. The ritual for worship in that temple is to advance to the altar, and make obeisance to the left-side face, saying " Maybe," and then to make a deeper obeisance to the right-side face, saying " Unquestionably."

Let no believer in the true faith of the customer's *property* rights so much as cross the threshold of that temple.

The mischievous effects of this opinion have been shown in a number of ways. It has all the appearance of lucidity but all the reality of confusion.

It has seriously impaired the prestige of the New York Court of Appeals with other courts, for no shrewd judge is going to follow the lead of a dust-cloud. And it has tended to confuse some judges in the New York Appellate Division on a fundamental point in the law of conversion (to wit, — that " demand and refusal " are of the essence in that species of conversion which is a tortious *withholding* of the possession, but are immaterial in that species of conversion which is a tortious *transfer* of the possession). And it caused even that very strong court, the U. S. Circuit Court of Appeals for the Second Circuit, to yield a full pail of milk and then kick it over; for that court, after having demonstrated in a powerful, persuasive opinion that the tortious pledge *was* a conversion, that it *was* a violation of *property* rights, nevertheless, on a rehearing, modified its opinion and laid down a rule for measuring damages which will be seen on analysis to be based on the doctrine that the stockbroker's only duty is to pro-

duce the wherewithal to make a delivery *when the customer is minded to sell,* which is *precisely* the doctrine advocated by the *dissenting* judges in *Markham v. Jaudon,* and twice rejected by the majority of the New York Court of Appeals. See pp. 269–273.

For example. On June first, the stockbroker converts the customer's stock when the market is in a panic. The stock had been selling around 100, but on June first it broke to 80. During June, however, it *rebounded* and touched 100 again. Then it sagged and by January first it was back to 80 and continued thereafter to drop. If the stockbroker gave notice to the customer on June first of what he had done, the customer is entitled in an action for conversion to have the stock valued at 100, but if the stockbroker aggravates his wrong by keeping it dark, and the customer has no notice of the wrongful act until January first, the stock is to be valued at 80. This is a *reductio ad absurdum,* but the customer finds it difficult to laugh.

The discussion of the rights of margin customers is the main, but not the sole topic, discussed in the book. A swift flight is taken over the whole law of pledge, from the time of Glanville (1181) to the present time. It becomes pertinent to speak of many things — of disseisors and rows, of warrantors and cows, of bridegrooms and their brides, of patricians and their prides — which when first they meet the mental eye seem to have nothing to do with the case. But the law is a seamless web; the cloth of the common law has been aweaving for over eight centuries, and all these things are part of the woof and warp. No topic in the common law can be understood if it is isolated from other topics.

Conversion is a difficult and rather technical topic, and therefore a long foundation chapter (Chapter V) has been given to Trover and Conversion, and there are four appendices (B, C, D and E) on cases in the law of conversion other than pledge cases.

The discussion of the rights of margin customers against wrongdoing stockbrokers involves, in some cases, the principle that any separation by a pledgee of the security from the debt is, without

more, a conversion of the security. The cases which are margin customer cases are only part of the separation cases. In Chapter XI, therefore, a summary statement has been made of what, we submit, the law ought to be on this rather puzzling topic; the authorities are a bog.

The most difficult case mentioned in Chapter XI is case 6, where A gives B a non-negotiable promissory note secured by jewels, so that both debt and security are legally second-class. B is a rascal and he assumes to sell the jewels to D, a bona fide purchaser, and delivers them to D. Then *later* B indorses and delivers A's note to C, another bona fide purchaser. What are the rights of the parties? Must A pay anyone? If so, should it be C or D? To prepare to answer this question — which we appraise as the most difficult question, intellectually, in the whole of the modern law of pledge — we have a long foundation chapter (Chapter IV) on the assignability at law of debts before default. The peak of that chapter is the dialogue between Williston and the author (pp. 80–89).

We seek to build a juristic structure with foundations as solid, and with lines as simple and stately, and with vistas as spacious as those befitting a colonial mansion.

In laying the foundations, we begin afar off.

CHAPTER II

MORTGAGES, PLEDGES, LIENS

THE idea of giving security for the performance of a duty is at least as old as civilization. Human beings may be delivered as hostages; or human beings may give supporting promises as sureties; or property, real or personal, may be given as security.

Glanville [1] did not speak of hostages but he did give a broad scope to the word "pledges." He spoke both of "the giving of pledges" and of "the putting things in pledge." When he spoke of "the giving of pledges" he meant the giving of sureties. Thus he said: "When the pledges appear in court, they will either confess their suretyship or they will deny it." [2] When he spoke of "the putting things in pledge" he used "pledge" as a term broad

[1] Ranulf de Glanville (or Glavil, or Glanvill) became Chief Justiciar of all England in 1180 and served Henry II in that capacity until the death of that Sovereign in 1189. Richard I on his accession removed him from office, imprisoned him, and required him to pay a large ransom. He, however, accompanied Richard on the crusade, and perished at the siege of Acre (or Acon) in 1190. He stood high in the confidence of Henry II. The Chief Justiciar sat in the *Curia Regis* next to the King, as Chief Judge in all civil and criminal questions coming before that court; and governed the country like a Viceroy when the King was, as he frequently was, beyond the sea.

There has come down to us a treatise on the Laws and Customs of the Kingdom of England which is reputed to have been composed by Glanville in 1181 (or thereabouts). Coke's appraisal of this treatise was high. It was in Latin. It was not printed, apparently, until well into the sixteenth century. Our quotations are from the translation by Beames, printed in 1812.

This is the first treatise on the common law which has come down to us. Littleton's treatise on Tenures was printed in 1481 (or thereabouts), and was the first treatise on the common law to be printed. Glanville was one of the earliest of the Plantagenet judges; Littleton was one of the latest (p. 43). It is interesting to note that, if the dates for the writing of the treatise by Glanville and the printing of the treatise by Littleton were what competent antiquarians think that they were, precisely three centuries intervened between the first treatise, and the first *printed* treatise, on the common law.

[2] Book X, Chap. V.

enough to include mortgages both of chattels and of real property. Thus he said: "A loan is sometimes made, upon the credit of a putting in pledge. When a loan of this description takes place, sometimes moveables, as chattels, are put in pledge; sometimes immoveables as lands and tenements and rents, whether consisting in money, or in other things." [3]

But as time passed "pledges" ceased to be the generic word, being replaced by "securities." Its scope was much narrowed, and "pledges," as that word is today almost always used, is only *one* species of *property*-securities, to be contrasted with two other species of property-securities, to wit: mortgages on the one hand, and liens on the other hand. These are *not* the only property-securities known to our law, but for the purposes of this book it will be sufficient to state the outstanding dissimilarities, and similarities (for they are similar in important respects) of these three species of property-securities: (1) Mortgages, (2) Pledges and (3) Liens.

1. *Mortgages.* A mortgage may be of real property. In early English law if A, owner of an estate in fee simple in Blackacre, borrowed from B on the security of the land, he would give to B his promise to pay, and would convey to B an estate in fee simple in Blackacre, defeasible upon his paying the debt according to its terms. B would have a fee simple defeasible, and A, if he by agreement with B remained in possession, would be merely a tenant of B. This conception of a real estate mortgage still persists in some jurisdictions, although in many jurisdictions today a mortgage is treated as giving to B not a defeasible estate in fee simple but only what is called a mortgage lien. Whether the lien theory or the title theory is adopted, however, a mortgage of real property is a property-security which is *not* dependent upon possession.

A mortgage may be of personal property. Now ownership of chattels is absolute, and one conception of a chattel mortgage is that the absolute title passes, with a duty upon the mortgagee to reconvey upon payment. Another possible view is that the mortgagor continues to be the owner and that the mortgagee has only

[3] Book V, Chap. VI.

a mortgage lien. Under either view, it is clear that a mortgage of personal property is a property-security which is *not* dependent upon possession.

2. *Pledges.* There is today (contrast the time of Glanville) no such thing in our law as a pledge of real property, — all pledges are of personal property.

In business substance, a mortgage of *personal* property and a pledge are on many points similar. But there are two important differences:

(a) Roughly speaking, a mortgage is created by the delivery of an instrument, a pledge by the delivery of the property itself. No delivery of the possession is necessary to create a mortgage, and no written instrument is necessary to create a pledge. The mortgagee is not entitled to the possession *until default* by the mortgagor, but the pledgee gets possession *forthwith.* As to possession, the mortgagor is still in, the pledgor is out.

(b) Prudence will require that the mortgage be recorded in accordance with the terms of the applicable recording act. The usual recording acts do not apply to pledges, but the courts, to prevent the misleading of persons who are or may become creditors, do require that the possession of the pledgee be "open." On the one hand, there is a *statutory* requirement of *record* for a *mortgage,* and, on the other hand, there is a *judicial* requirement of *"open"* possession for a *pledge.* The statutes provide for record notice in case of a mortgage; the courts provide for notice *in pais* in case of a pledge.

Business men, driven to borrow money on the security of personal property, naturally wish that fact to be given as little publicity as may be. They wince at a recorded mortgage, and they also want to do just as little about making the possession of the pledgee "open" as the law requires. Many an anxious hour has been spent by lawyers seeking to devise something acceptable to the lender, which will steer their client between the Scylla of record and the Charybdis of "open" possession. There are legal helmsmen who are confident that they can do it.[4]

3. *Liens.* "Lien" is one of the most slippery words in the

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[4] See *Moors v. Reading,* 167 Mass. 322, 45 N. E. 760, 57 Am. St. Rep. 460 (1897).

law. For example. A court may say: "It is important to distinguish between a pledge on the one hand and a lien on the other hand," and yet may, within half a dozen lines, speak of "the lien of a pledge." Obviously, such court is using "lien" in two quite different senses. Sometimes "lien" is used as a term having a very broad scope, — as though it covered *all* property-securities. It is so used when a court speaks of a mortgage lien upon real property, or of that very important property-security, a vendor's lien (the discussion of which is outside the scope of this book), or when a legislature speaks of a mechanic's lien. But sometimes "lien" is used as a term with a belittling connotation to describe a property-security (1) which is dependent upon possession, and (2) which is *inferior* in dignity and importance to a pledge. It will aid clarity if we speak of such a lien as a mere lien. Pledge and mere lien do sit at the same table, but pledge sits above the salt and mere lien sits below the salt.

There are four kinds of mere liens: (a) common law liens; (b) statutory liens which the legislature has intended should be dependent upon possession; (c) liens by usage confirmed by the courts which by the usage are dependent upon possession; and (d) liens by contract which by the understanding of the contracting parties are dependent upon possession.

(a) Common law liens are given by the law itself. They are all dependent upon possession. Notable examples are the lien of a common carrier upon goods carried, of an innkeeper upon the baggage of a guest, and of any bailee who "improves" the bailed chattel at the request of the bailor. The common law took a distinction — a rather fine distinction — between improving a chattel and sustaining or preserving it. Thus, if A sent race-horses to B, a trainer, to be prepared for racing, B had a lien; but if A sent horses to B, a livery stable keeper, to be stalled, fed and groomed, B had no lien.

(b) Statutory liens are *sometimes* dependent upon possession. Whether a particular statutory lien is or is not dependent upon possession must, of course, be determined by a sound construction of the statute in question. Statutes giving a livery stable keeper a lien have commonly been construed as giving a lien dependent

upon possession, so that the lien ceases when the possession is surrendered.[5]

(c) If a lien is of usage origin, the usage may, or may not, make the lien dependent upon possession. The notable examples of liens by usage which have up to date been confirmed by the courts are the lien of a factor for his charges *and* the payment of advances; the lien of a banker upon the assets of a customer over which by proper conduct in the course of the banking business he has acquired control; and the lien of an attorney upon the assets of his client over which in the proper discharge of his duties as attorney he has acquired control.

The only lien by usage which we shall have occasion again to mention is the lien of a factor for his charges *and* payment of advances. It is clear that that lien is dependent upon possession. "Factor" and "mercantile agent" are often used as though synonymous. In the Factor's Act, so called, passed toward the close of the reign of Queen Victoria[6] it was provided: "The expression 'mercantile agent' shall mean a mercantile agent having in the customary course of the business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods." We are under the impression that at the present time in this country the word "factor" is not much used by business men. They speak rather of commission merchants, or selling agents, or purchasing agents. But we believe that the legal definition of the word "factor" today in this country accords with the statutory definition given above.

(d) Liens by contract. It may be the understanding of the parties that a lien so created should be dependent upon possession.

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[5] See *Seebaum v. Handy,* 46 Ohio St., 560, 22 N. E. 869 (1889). If the bailee surrenders the possession on an understanding that the bailor will make some temporary use of it and then return it, and he does return it, the lien revives and covers past charges. See *Allen v. Smith,* 12 C. B. (N.S.) 638, 31 L. J., C. P. 306, 6 L. T. (N.S.) 459, 9 Jur. (N.S.) 230, 10 W. R. 646 (1862). Probably, the law is that, when the bailee has so surrendered the possession but the bailor has not yet returned the property, the bailee has an equitable lien good against all but bona fide purchasers. Compare *Caldwell v. Tutt,* 10 Lea (Tenn.) 258, 43 Am. Rep. 307 (1882) with *Vinal v. Spofford,* 139 Mass. 126, 130, 29 N. E. 288 (1885).

[6] 52 & 53 VICT., c. 45.

In a case where A delivered type to B to be used by B in printing a book for A, the court held that B had no lien on the type for his charges because he had not improved the type, but intimated that in such a case if there had been an agreement between A and B that B should have a lien the court would have supported it.[7] Pretty surely, the court was thinking of a lien dependent upon possession. We submit that for a court to support any lien of contractual origin other than a lien dependent upon possession would be inconsistent with the public policy evidenced by the usual recording acts.

Precisely where is the line drawn between a pledge and a mere lien? It is obvious that the transaction in which A borrows money from B and delivers to him personal property as security, and the transaction by which a factor makes advances to his bailor are, in business substance, very close to each other, yet in the first case the law calls the transaction a pledge, and in the second case a lien.

We submit that the line between a *pledge* and a *mere lien* is as follows: If A bails personal property to B, the *primary* purpose of the bailment being to give *security to B* for the fulfilment of a promise, B is a pledgee. But if A bails personal property to B, the *primary* purpose of the bailment being that B shall render *services for A* with respect to the property bailed, and B is entitled to detain the property until charges are paid, B is a lienee.

Under this test a factor is a lienee, — the primary purpose of the bailment being that he shall render services to the bailor. It is clear that he would have a mere lien for his charges for storage, and so forth. If he does make advances, the courts might conceivably have severed such transaction and given B, with respect to payment of the advances, the rights of a pledgee. But this they have not done. B is not part lienee-by-usage and part pledgee-by-common-law, — he is one hundred per cent lienee-by-usage.

We said above that pledge sat above the salt, and that mere lien sat below the salt. The main differences between a pledge and a mere lien are as follows:

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[7] *De Vinne v. Rianhard,* 9 Daly (N. Y.) 406 (1880).

1. Upon default, the pledgee may make a liquidating sale. For a detailed statement of the conditions upon which such a sale is authorized, see pp. 188–190. But the mere lienee has no authority to sell, — he has only a right to detain, a mere worrying asset.

2. Tortious conduct which will work a forfeiture of a mere lien will not *necessarily* work a forfeiture of a pledge. This is discussed at some length in Chapter VII.

3. The courts are definitely more favorable to the assignability of a pledge than to the assignability of a mere lien. There are decisions and dicta countenancing the thought that pledges are *always* assignable and that mere liens are *never* assignable. We submit that the law should be as follows: Let the court decide whether the debt is, or is not, assignable. If not, then the security should not be assignable, for debt and security should never be separated. But if the right *in personam,* the debt, is assignable, then the right *in rem,* the security, should be assignable, whether that right *in rem* is a pledge or a mere lien. The law has usually been more favorable to the assignment of a right *in rem* than to the assignment of a right *in personam,* and it would therefore be anomalous if the principal, primary thing (the right *in personam*) should be assignable, but nevertheless that the supporting, secondary thing (the right *in rem*) should not be assignable.

We are aware that it has been said that a "mere lien" is only a right to detain, and does not amount to a right *in rem.* But it certainly is a right to detain a *res* until a debt is paid, and is therefore not dissimilar to a pledge. We can see no justification for refusing to recognize that a lien, even a mere lien, is one kind of rights *in rem.* It is a *property*-security.

The law as to assignability of liens is not clear. We confess that we do not know just what it is, and are far from being confident that the law *is* what it seems to us that it *ought to be.*

There is one point incident to assignment of pledges on which the law would seem to be clear (although there are not many authorities on the point). It is a point of large importance to banks and other lenders of money upon security.

A borrows from B on pledge. The debt is evidenced by a negotiable instrument. Before default by A, and without con-

sulting or notifying A, B assigns debt and security to C. C by his tortious conduct thereafter destroys or damages the security. Is B exposed to liability? The answer to that question is: " No." B's assignment was lawful. He completely dropped out of rights and *also* out of liabilities. He did *not* become his assignee's keeper. There will be no boomerang of liability. A must seek redress from C, and from C only.[8]

We conjecture that there are some pledgors who do not realize that this is the law. It may be noted that the authority of a pledgee to assign (although not, we think, his legal capacity to assign) may be restricted by agreement between the pledgor and pledgee.

So much for the dissimilarities between mortgages, pledges and mere liens. Now, to emphasize the underlying, fundamental similarity.

All three give security to the holder (mortgagee, pledgee or lienee) that something shall be done or shall not be done. This something is not necessarily, but is usually, the payment of a debt, and we shall in this book discuss or cite only cases where the mortgage or pledge or mere lien is security for the payment of a debt. In *all* such cases, we submit that the mortgage or pledge or mere lien is a right *in rem* buttressing a right *in personam.*

The courts are, and always have been, unanimous that the debt, the right *in personam,* is the principal, primary thing, and that the security, the right *in rem,* is the supporting, secondary thing.

The courts are today unanimous that tortious conduct by the creditor which forfeits the security *never* forfeits the debt. The supporting, secondary thing may die, but the principal, primary thing still lives in unimpaired vigor.

The courts are, and always have been, unanimous that *whatever extinguishes the debt extinguishes the security.*[9] True, in case of a recorded mortgage, the debtor who pays must be careful to have the fact of payment appear on the record lest he be exposed to the risk that the discharge may not be effective against

8 See *Goss v. Emerson,* 23 N. H. 38 (1851).

9 Story, Bailments, §§ 359–364.

third persons. In the case of a pledge or mere lien, however, payment of the debt *automatically* ends the pledge or lien interest, and the quondam pledgee or lienee is left with *nothing but the possession.*

To illustrate. A borrows $5,000 from B on the security of jewels worth $10,000. A's debt is evidenced by a negotiable instrument. B is a rascal, and he sells the debt to C, a bona fide purchaser, and later sells the jewels to D, another bona fide purchaser. C demands that A pay the note. A makes a conditional tender of the amount due, the condition being that C produce and surrender the jewels. C says that the jewels are no concern of his, and sues on the note. It is clear that C wins against A.

Now, assume that A satisfies C's judgment, and that *then* A goes to D and demands his jewels, *making no tender of any amount,* and that D refuses to surrender them, and that A then sues D.

Counsel for D argues: "When D bought the jewels from B, it is true that B did not have a $10,000 interest in the jewels, but he did have a $5,000 interest. If B, life tenant of Blackacre, purports by deed of bargain and sale to convey the fee to D, the conveyance will not be wholly abortive, it will pass what B *did* have, — the life estate. So here, I concede that D did not acquire a $10,000 interest in the jewels. But I urge that he *did* acquire a $5,000 interest, and therefore that A was not entitled to the jewels without tendering $5,000 to D."

Counsel for A replies: "I concede that, *if there had been no C,* D would have been entitled to hold the jewels until A tendered $5,000. *But there was a C.* A has paid C. The instant A did that, the pledge interest ceased. Its *raison d'être* was gone. It just evaporated. Counsel for D replied upon a supposed analogy to the case of another D who thought he was acquiring from a B the fee in land and who only acquired an estate for the life of B. Now, suppose that B later died. What then would D have? Nothing, but the possession. So here. D in his argument has hoisted himself with his own petard. A pledge interest is in its nature defeasible, terminable. It is *always* terminated when the debt is paid *to the person entitled to receive payment of the debt.* C, not

D, was that person. Therefore, D had nothing but the possession of the jewels, and consequently converted them when he refused to give them up on demand."

Is there any chance to save D? His counsel might well argue as follows: "I concede that C was the person entitled to receive payment of the debt. I also concede that whatever extinguishes the debt extinguishes the pledge interest. Nevertheless, I submit that A has no standing to complain of D. *It was A who started all this trouble.* All A had to do to prevent trouble, was to write just three words on his note: "Secured by collateral." If he had done that *there could not have been two bona fide purchasers,* one of the note and the other of the jewels. This lawsuit could never have arisen. Ordinary prudence to save himself from trouble required that he do this simple act. And, if he had reasonable consideration for others, he would not have given B the opportunity to put a bona fide purchaser of the jewels in a position where he would not even be the person entitled to receive payment of the debt. A therefore should have no greater rights than he would have had if C had *not* been a bona fide purchaser of the debt."

We hazard no prediction as to whether a particular court would sustain such a defense, but we think that the argument is worth making. We speak of this again in Chapter XI.

This brings us within sight of one of the most puzzling problems discussed in this book:

Change the facts somewhat. Make the note by A to B non-negotiable. Make the sale of the jewels to D come *before,* not after, the sale of the note to C. What in such case are the rights of A and C and D? That *is* a question. It is a question fit to test the mental steel of any man. Of this, more hereafter in Chapter XI.

CHAPTER III

DEBTS AND SECURITIES

DEBTS. When A borrows money from B he usually makes an absolute promise to pay a defined sum of money, or a defined sum of money with interest, payable either on a specified date (time loan) or on the demand of B (call loan). That creates a debt. Is there anything wrong about that? A is at once a debtor. Is he also at once a wrongdoer?

" Debts " is a term which has sometimes been used as though it were synonymous with " defects of conduct," with wrongdoing. " Forgive us our debts, as we forgive our debtors." Millions of persons as very little children have first heard the word " debts " when they were taught the Lord's Prayer. The impressions made on the mind of a child frequently persist, at least in the subconsciousness, for life. This sentence in the Lord's Prayer has a strong tendency to couple debts with sins.

Now, no doubt, some debtors do *become* wrongdoers. A borrows from B, and later fails to pay according to the terms of the loan. He defaults. He may be reprimanded, denounced as a defaulter. Time was when he could be thrown into a debtors' prison. Many a child has read the descriptions by Dickens of a debtors' prison, and the tendency to associate debt with wrongdoing has thereby been increased.

Let the reader rid his mind of preconceived notions, and with an open mind face the question: *Is* borrowing wrong?

There are many estimable persons who would emphatically denounce borrowing. They pride themselves on never having borrowed a dollar; they would be embarrassed, ashamed to do so. They are fond of saying: " Neither a borrower nor a lender be," and are inclined to say it with an air that connotes that nothing more need be said. In their minds there is a very close association between debts and defaults. And, no doubt, borrowing is the resource of the shiftless, the foolish, the desperate and those who *will* keep up with their neighbors. And no doubt there is always

some risk of disaster inherent in borrowing. Payment-day is sure to come around, but the wherewithal is not sure to come around. Many a man, and many a corporation, and many a government has come to grief by optimistic borrowing. A sensible, prudent, shrewd person thinks at least twice before undertaking any venture or purchasing stocks or motor cars or anything else if borrowing (in form or in substance) will be necessary.

On the other hand, it should be recognized that the business of the country is to a very large extent conducted on borrowed money. The capital structure of most (not all) large corporations is built up to well over half, sometimes to over two-thirds, of the total height out of borrowed money. Banks serve a useful purpose by attracting deposits and lending much of the money deposited to aid the conduct of business. In many businesses, borrowing, at least at certain seasons of the year, is regarded as a normal incident. Many of the most useful, desirable, strong men in the community are *chronic* borrowers. Men of this stamp are fond of saying that the aversion to debts should not become a fetish, that the ideal is not complete freedom from debts, but rather that there be a large excess of assets over liabilities with complete freedom from *defaults*.

There has been an extraordinary amount of loose thinking and loose talking about the evils of the borrowing and lending of money. We believe that, if the reader is able to rid his mind of preconceived notions, he will see clearly that the law should not regard the *creation* of a debt as a wrong. There is really no more justification for coupling " debt " with wrong than there is for coupling " promise " with wrong. The wrong is not in making a promise but in breaking it. Similarly, the wrong is not in creating a debt but in defaulting.

Let a bright line be drawn between debts not yet due, and debts upon which there has been a default. Some business men prefer to speak of loans rather than debts. They style themselves borrowers and wince at the word debtors, which shows that even in the minds of men who are chronic borrowers the use of " debts " to describe borrowings would have for them unpleasant connotations. Call a man a chronic debtor and he will not like it. It is

perhaps unfortunate that the law applies the term debt to an unmatured obligation to pay money, but it certainly does. But let it be clear that debtors who have not defaulted are *not* wrongdoers.

We suggest that debts incurred by borrowing be divided into three classes: First, debts evidenced by a negotiable instrument. Second, debts evidenced by a non-negotiable instrument. Third, debts not evidenced by any instrument.

We shall later consider the assignability *at law* of each of these classes of debts, *before default*. Our purpose in this chapter is to prepare the mind of the reader so that he may readily see that there may be objections to the assignability of debts *after default* which have no application to the assignability of debts *before default*.

Securities. We suggest that securities be divided into two classes: let the expression " first-class securities " be applied to property in which a bona fide pledgee gets *independent* rights, — that is to say, rights which *may* be greater than the rights of the pledgor; and let the expression " second-class securities " be applied to property in which even a bona fide pledgee will get merely *derivative* rights, — that is to say, rights limited by, and never greater than, the rights of the pledgor. With first-class securities the bona fide pledgee is never disappointed, — *he always gets what he thinks he is getting*. With second-class securities he may, or may not, be disappointed as the case may be. When a pledge is made, the pledgor usually has what he asserted he had, but sometimes he in good faith thinks he has more than he has, and sometimes he is a rascal and asserts that he has what he knows he has not. The difference between first-class securities and second-class securities is so important that today a bank will rarely, if ever, make a loan on personal property unless the securities are first-class in the sense in which we use that expression. On the other hand, probably the bulk of pawnbrokers' loans are upon second-class securities.

In discussing " independent " rights, we shall inquire as to the circumstances in which a bona fide *purchaser* gets independent rights. There are some topics ahead of us where we shall need to

know what are the rights of bona fide purchasers, and that question may as well be fully discussed forthwith. For if a bona fide purchaser will prevail, a bona fide pledgee will prevail, — the greater includes the less.

This then is the question: A is the owner, B, a rascal, is the possessor, C is the bona fide purchaser from B. When does A prevail over C? When does C prevail over A? It is the eternal triangle of the law, — two good men and one rascal. We should all like to protect *both* A and C, but under our law one is taken into full protection, and the other left to his remedies against the rascal (which will as a practical matter probably be worthless). There is in our law no support for the idea of avoiding the trouble of untying the knot by cutting it, — by giving A and C a fifty-fifty split.

The cases in which C wins fall into two groups: In the first group, C is protected even if B is a finder or a thief; in the second group C is only protected if B has been entrusted by A with the possession.

1. *Cases where C wins, even if B is a finder or thief.* The earliest cases giving such a result were market-overt cases. B steals A's chattel and sells it in market-overt to C. C wins over A. Why? The hardship to A if he loses is as great as the hardship to C if he loses. It may therefore be urged that, since the scales are poised, there is no ground for disturbing the *status quo,* and letting C acquire the title at A's expense. Moreover, if A loses, that has some tendency, by weakening the protection for property, to discourage other members of the community from acquiring property by the today almost forgotten virtues of working hard and saving.

On the other hand, protection for C was good for business in the market-overt, and the merchants in places which did have market-overts were of course strong for protecting C. And it is always to be remembered that every member of a community is not merely an individual, but is also a member of a composite whole, the community, and that he is interested, *selfishly* interested, in the prosperity of the community of which he is a member. If he will take a large view, he will see that on the whole it is to

the advantage of individuals that legislatures and judges should lay down legal rules which will work to the advantage of the community by facilitating the conduct of business, and thereby increasing the prosperity of the community, even if the application of some particular rule shall in a particular case work to the disadvantage of a particular individual. The idea of sacrificing individuals for the benefit of the community may, no doubt, be carried too far. Men have differed, and probably always will differ, as to the extent that this idea should be carried, but we know no broad-minded person who does not cordially recognize that it should be given considerable scope.

The precise origins and limits of the market-overt rule are obscured by the mists of time, but for centuries the English law has, as a general rule, decided for C.[1] In the United States, however, we have never had market-overts. Note that some, but by no means all, English places had the franchise or privilege of a market-overt. In this country no *place* has ever been given such a special privilege, and the market-overt doctrine has never been received in this country.[2]

The English law also came to be (centuries after the origin of market-overt law) that C would also be protected if he purchased a certain *kind* of property, no matter in what *place*. This principle came to be applied to bonds payable to bearer, and also to promissory notes, bills of exchange and checks which were payable to bearer *or* were payable to order and indorsed in blank. These are negotiable instruments, in negotiable form. The bona fide purchaser in due course is protected if he purchases from a finder or even if he purchases from a thief. An instrument payable to bearer is in negotiable form from the start. But an instrument payable to the order of the payee, although it is a negotiable instrument from the start, is not in negotiable form until indorsed, and the last indorsement (if there be more than one) is in blank.

This country has had no hesitation about following the English law on this point. Indeed, in recent years there has been a noteworthy extension of the scope of negotiable instruments by stat-

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1 *Clayton v. LeRoy*, [1911] 2 K. B. 1031.

2 *Wheelwright v. Depeyster*, 1 Johns. (N. Y.) 471, 3 Am. Dec. 345 (1806).

utes which have been passed in many (but not all) states. Today, for example, in a majority of the states stock certificates indorsed in blank, bills of lading indorsed in blank, and warehouse receipts indorsed in blank are, by statute, negotiable.

2. *Cases where C wins, under a doctrine of possession, plus.* In this group of cases A has entrusted B with the possession. B is a bailee. These cases are sharply to be distinguished from the cases where B is a finder or a thief. Mere entrusting by A of B with the possession is *not,* without more, enough to protect C. There must be possession, *plus.* The circumstances must be such that B becomes the apparent owner. For example. B has cars for sale. A buys one which is standing in B's store, and pays for it. He tells B to let it stand just where it is for a day. After A has gone, B, a rascal, sells it to C, a bona fide purchaser. C wins.

Another example. A owns a certificate of stock. He indorses it in blank and entrusts it to B. B tortiously sells it to C, a bona fide purchaser. Even in the days before the statutes making such stock certificates negotiable had been passed, C won. A had "clothed B with the indicia of ownership." [3] This principle is still important in those states where as yet no statute has been passed making such certificates negotiable. In those states the bona fide purchaser is not protected if B is a finder or a thief, but he is protected if B is a wrongdoing bailee, entrusted by A with the possession of stock certificates indorsed in blank.

A word of caution. It is clear that B must have been entrusted with the possession, and that B must be the apparent owner. But it does not follow that in *all* such cases C wins. At least some courts take into consideration the *degree* of trust reposed in B by A.

To some extent, this principle of possession, *plus,* has been made more precise by statute. And this brings us to a famous case.

We have previously seen that a factor to whom goods are consigned for sale has by usage a lien for advances made (p. 15). Now, in *M'Combie v. Davies* [4] A consigned to B, B advanced £30, and then B tortiously pledged the goods to C for a loan from C

[3] *McNeil v. Tenth National Bank,* 46 N. Y. 325, 7 Am. Rep. 341 (1871).

[4] 7 East, 5 (1805).

to B of a larger sum than £30. A demanded the goods from C without tendering him anything. C refused to surrender. The court held that C had converted the goods and was liable to A for the full value, without deduction of the £30.

This was not satisfactory to merchants. The legislature intervened, and passed a so-called Factor's Act. The efficacy was enlarged in later statutes.[5] In this country there are twelve states in which statutes, more or less similar, have been passed.[6] Some of these merely confirm the common law principle in general terms. Others are definitely more specific.

To sum up as to the distinction between first-class securities and second-class securities. First-class securities are property in which C, the bona fide pledgee, has *independent* rights, that is to say, rights which *may* be greater than the rights of the pledgor. He gets what he thinks he is getting. The extent of the rights of B, the pledgor, is immaterial. At the present time first-class securities are either (a) instruments which are negotiable either because of judicial decisions or because of a statute, and which are in negotiable form, or (b) property where the principle of possession, *plus,* applies either by decision or statute. Second-class securities are all other securities, — securities in which even a bona fide pledgee will get merely *derivative* rights, — rights limited by, and never greater than, the rights of the pledgor.

This distinction between first-class and second-class securities is, of course, a *legal,* not a *financial,* distinction. It may well be that C will take a security which is legally second-class, but that he will be all right because B did have what he purported to have. And it may also well be that a legally second-class security is financially superior to some legally first-class security.

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[5] See 4 Geo. IV, c. 85; 5 & 6 Vict., c. 38; 52 & 53 Vict., c. 45.

[6] Ala. Code Ann. (Michie, 1928) § 9539; Cal. Civ. Code (Deering, 1937) § 2369; Ga. Code (1933) §§ 96–207; Me. Rev. Stat. (1930) c. 44, § 1; Md. Ann. Code (Flack, 1939) art. 2, §§ 1 *et seq.;* Mass. G. L. (1932) c. 104, §§ 1 *et seq.;* Mont. Rev. Codes Ann. (Anderson & McFarland, 1935) § 7980; N. Y. Cons. Laws (Cahill, 1930) c. 42, § 43; N. D. Comp. Laws Ann. (1913) § 6371; Ohio Code Ann. (Throckmorton, 1940) § 8358, Ohio Gen. Code (Page, 1926) § 8358; Pa. Stat. (Purdon, 1936) tit. 6, §§ 18, 201; R. I. Gen. Laws (1938) c. 392, § 2; S. D. Code (1939) § 3.0303 Tenn. Code Ann. (Williams, 1934) § 6676.

The reader will find that the judges not infrequently speak of " the power of a bailee, or finder, or thief to convey a good title." Unless we watch our step, we shall stumble into a mire of confusion. " Power " is a very slippery word. It is even more slippery than the word " lien " (p. 12). It is exasperatingly ambiguous, Delphic.

Popularly the word " power " is used as a synonym of might, force, strength. It does not always connote right, — sometimes it does and sometimes it does not. We speak of the power of prayer (always making for the good), of the power of example (sometimes making for the good and sometimes making for the bad), of the power of temptation (always making for the bad). But if the word power is used in the law, should it not always indicate a strength the exercise of which does *not* involve a wrong? We regret that judges have not seen fit so to confine the scope of " legal power," but it is clear that they have not.

Take the important topic of *ultra vires* transactions in corporation law. Years ago the author was lost in the labyrinth of decisions. Searching for a clue which would take him out, he found it in the distinction between legal *capacity* and legal *authority*. That distinction threw a flood of light upon the corporate problems, and as the years have gone by he has repeatedly found it very helpful in solving other problems. He knows of no distinction more fundamental than the distinction between legal capacity and legal authority.

For example. " *Ultra vires* " means " beyond its powers." " *Intra vires* " means " within its powers." Now a corporation, Y, is created by State X. In the special act creating it, or in its certificate of incorporation (if it is incorporated under a general law) its " purposes " are defined. Now, suppose that the officers of Y in its name, with its funds, and for its benefit do some act outside the scope of the purposes. Is corporate significance attached to that act? Sometimes " yes," sometimes " no." The act *may* be treated as merely the act of the human beings, or it *may* be treated as the act of the corporation. Such an act may be a ground for a *quo warranto* proceeding by X against Y, but it does not necessarily follow that third persons did not acquire rights

against Y. It does not even necessarily follow that Y did not acquire rights against third persons. Y may have legal *capacity* to do acts, the doing of which is a wrong as against X. With respect to such acts, we suggest that they be called acts within the legal capacity, although not within the legal authority, of X. *There may be a spread between legal authority and legal capacity.* The spread is the point. Capacity and authority are not necessarily coterminous. There may be an outer, larger circle of *capacity,* and an inner, smaller circle of *authority.*

Now, we do not attempt to define here what acts done in the name of a corporation are under the authorities within corporate capacity although beyond corporate authority. That would take a book longer than this book. Nor do we attempt to make an exhaustive enumeration of all the situations in which legislatures or judges have used the word "power." But there are five situations to which we call the attention of the reader:

1. *A power of appointment.* A, owner of land, by deed conveys it to B for life, and gives to C a power of appointment over the fee (subject to this life estate). The state of the title at that moment is: B for life, reversion to A in fee, such reversion being defeasible by the exercise of the power by C. Later, C exercises the power in favor of D in fee. Now, sometimes a C will be given the right to appoint only *if* something is done or not done, and sometimes a C will be given the right to appoint, say, *only* to members of a defined class. If the power is unconditional and if C is given a free hand to appoint to whom he pleases, D would in such case take the fee, subject to the life estate, and A would cease to have any estate.

But assume that the power was on a condition, and/or that permissible appointees were limited to the members of a defined class, and that an appointment was made by C in D's favor which was outside the scope of the appointment, — either because a condition had not been performed, or that the appointee was not a member of the defined class. And assume further that D paid value to C for making such appointment, and that D, relying on the advice of reputable counsel, believed, and reasonably believed, that C was authorized under the terms of the deed to make this appointment. We do not know of any cases in which it has been

held that D wins. There is *no spread* between authority and capacity. If a donee of a power has not legal authority to make a certain appointment, then neither has he legal capacity. The use of the word " power " in such a case in not confusing, for authority and capacity are coterminous.

2. *A power of attorney.* A makes B his attorney-in-fact or agent (we use the two terms as synonyms) to act in A's name, for *A's* benefit, for certain purposes only. B does an act in A's name which is not authorized under the power of attorney. A third party, C, is involved. All courts rule that C may hold A liable if the act was within the " apparent " authority of B. Here there *is* a spread between legal authority and legal capacity, — the legal capacity is larger than the legal authority.

3. *Power of a bailee.* This brings into play the doctrine of possession, *plus.* It is very closely analogous to case 2. There *is* a spread between legal authority and legal capacity. B's legal capacity is larger than B's legal authority.

4. *Power of an assignee.* A is the owner of a debt *not* evidenced by a negotiable instrument. A " assigns " the debt to B. In Chapter IV we shall set forth at length our reasons for believing that the debt is, or at least should be, assignable at law. But some persons think that the debt cannot be assigned at law by the voluntary act of A, — that the legal title remains in A even after A's attempt to abdicate. Such persons have, however, no objection to treating the transaction as a " practical " or " virtual " assignment. Their conception is that the alleged assignment is to be treated as equivalent to a declaration of trust by A in favor of B of A's legal title (A to remain as the *passive* holder of the title), and also as the grant by A to B of a power to exercise *all* the rights incident to the legal ownership, such exercise of rights to be in A's name, *but for the benefit of B.* This case should be sharply distinguished from case 2. In case 2, B is authorized to act in A's name for *A's* benefit. In case 4, B is authorized to act in A's name for *B's* benefit. Since, by hypothesis, B is authorized to exercise *all* the rights of ownership, there can be *no spread* between B's legal authority and B's legal capacity. Authority and capacity are coterminous. In this respect case 4 is like case 1.

5. *The power of a thief.* This brings us back to negotiable in-

struments. A is the owner of a negotiable instrument which is in negotiable form. B steals it and sells it to C, a bona fide purchaser. The law is clear that C is now the owner. But precisely how did that come about? Someone may perhaps say: "Why does the 'how' matter? Why is it not sufficient that all courts reach the same result, even if they have travelled by different roads to reach it?"

The "how" would, we concede, not matter, if this were the only problem in the law. But the law grows, is constantly developing, and in the solution of *other* problems judges are constantly influenced not merely by results reached, but also by reasons given, and *even by language employed* in cases where the *results* have become clear law. And there *are* problems in the modern law of pledge the adequate disposal of which requires that the mind be clear as to the *reason* why C prevails over A in this case 5.

There are at least three conceptions as to the reason. The first conception is that the thief has the legal (*cf.* equitable) title. The second is that the thief, although he has no title, has a "power" to create a title in a bona fide purchaser. The third is that the thief has neither title nor "power," that C in nowise succeeds to A *through the thief*, but that A's title is transferred to C by operation of law.

We begin with the conception that the thief has the legal title, — the title theory. Take a bond payable to bearer. According to its terms the bearer is the legal owner. The thief becomes the bearer. Therefore, he becomes the legal owner. Therefore, he may transfer the legal title to C. So far as the *law* (*cf.* equity) is concerned, C does not need independent rights, — rights derivative from B are enough. Now, of course as between A and B, A was entitled to get the bond back. But the advocates of the title theory say that such right was only a right of rescission in equity, and that C prevails over A on the familiar principle that, if B has a legal title cumbered with an equity in favor of A and transfers that legal title to C, a bona fide purchaser, C takes that legal title free from the equity that had previously cumbered it.

Two minor objections have been made to the title theory. The

first is that while some negotiable instruments, negotiable in form, are payable to bearer, others are payable to the order of a specified person and later indorsed in blank. We see nothing in this objection. If there is an indorsement in blank, it is the intent of the indorser that the instrument shall now become equivalent to an instrument which was originally made payable to bearer.

The other minor objection is that, if A has only an equity, he could not, upon discovering that the bond was in B's possession, take it back by self-help or even by replevin, but would be driven to a bill in equity. This gives us pause. Now, it is true that if A owns an ordinary chattel and B by fraud induces A to sell it to him, although the title passes to B (and therefore C, a bona fide purchaser, will take that legal title free from the cumbering equity in favor of A), nevertheless, if B has not yet sold to a C, A may replevy from B. This is explained on the ground that there has been such a fusion of law and equity that today not infrequently the courts permit the use of legal remedies to enforce an equitable right, — that a court of law will treat A *as if* he had, as a preliminary, obtained from a court of equity a decree of rescission. That does not quite persuade us, for it does not cover the case where A used self-help to get the money back, and we supposed that equitable rights were only enforceable by court-help. However, it may be that there is some sufficient answer to this second minor objection.

We concede that the logic of the title theory is impressive. Moreover, it has the sanction of some jurists, including a jurist of such distinguished mind and pure fame as the late Dean Ames. Nevertheless, we cannot support it. We cannot adequately explain our reasons without making a digression long enough to enable the reader to see an arc of our thinking.

We do not highly appraise codes, or quasi-codes. If confined to fundamentals and if drawn by adequate draftsmen, they may be helpful as a means of rendering the law more certain and more clear. But the law is a living thing; it is, or ought to be, constantly developing, giving due consideration to new facts affecting the life of the community. No codifying Canute should assume to stay the tide. We are strongly in favor of giving

such power to judges as will enable them to guide the *development* of the law (but always attempting wholeheartedly to carry out any policy which the legislature may from time to time adopt).

In order to function adequately, there must be a window in the mind of a judge which gives upon the business world. No jurist, on or off the bench, is complete without a friend who is an experienced business man and with whom he may talk from time to time so as to get the business man's point of view on problems which he, the jurist, is trying to solve. A judge should give due heed — which is usually great heed — to the precedents, but a judge who gives heed to nothing else has his spiritual home in the past. He should respect the past, but he should not live there. On business questions the excellent judge is constantly seeking to keep his thought abreast of, and in harmony with, the thought of business men of experience and integrity.

That was the mode of approach to the solution of legal problems adopted by that most excellent judge, Mansfield. If a business question came before him he informed himself of the business man's point of view. What were the customs, the usages, the understandings, the modes of thought of business men? He did not *always* confirm these, — there *might* be some good reason blocking confirmation. But he inclined to confirm them. No one else has contributed so much as has Mansfield to the proper development of the law of negotiable instruments. *And yet all that Mansfield did was to confirm (within proper limits) the customs, the usages, the understandings, the modes of thought of business men.*

Now, the rule that the bona fide purchaser of a negotiable instrument in negotiable form prevails — that C prevails over A — did not, so to speak, come from above, like the Ten Commandments. It was *generated* below by merchants and then *confirmed* by the courts. The rule is supposed to follow and confirm the conceptions of business men. Then the courts ought to keep their thoughts, so near as may properly be, harmonious with the thoughts of business men. And we have never met a business man who thought of a thief as the owner of the thing stolen. This is

the reason, or at least the main reason, why we are unable to support the title theory.

A considerable number of jurists do not support it. What, then, is the explanation?

Some plunge into the depths of thought and come to the surface with the power theory in their mouths. "No," they say, shaking their heads, "the thief has not the title. Such an idea is shocking. Having no title, of course he cannot transfer a title, any more than a man can throw a ball if he has no ball. But the thief, although having no title himself which he can transfer to the bona fide purchaser, has a *power* to create a title in the bona fide purchaser. He is like the donee of a power of appointment."

Now, it is true that the law is familiar with *a* situation where a person having no estate in land has a power to create an estate in another. (Case 1, p. 28.) The owner of land, A, may give to C, a person who has no estate in that land, a power to create an estate in D; instead of at once fully disposing of the land himself, A may leave its future disposition to C, the donee of a power; the law does permit that. But there is no parallel whatever between that case, and the case of B, a thief, who sells a negotiable instrument in negotiable form to C, a bona fide purchaser. B has no authority whatever from the owner A. B does not even have an apparent authority from A (our cases 2 and 3, p. 29). B's *only* connection with A was a *tortious* connection. Such a connection is no proper basis for building up a legal capacity in B to bind A. B has not even a microscopic circle of authority from A to be enclosed within a very much larger circle of capacity.

Reject the notion that C succeeds to A's title *through B*. Grasp fully the conception that C's rights are *independent*, not derivative. Merchants thought, and the law has confirmed the thought, that C, the bona fide purchaser of a negotiable instrument in negotiable form, should acquire the title which A formerly had. For reasons of public policy there is a transfer of the title *direct* from A to C (no B conduit) by operation of law. This is done for the sake of the *community*, — for the large benefits which the community derives from the more facile and confident conduct of this kind of business (p. 24).

The author is keen to make his position on this matter crystal-clear.

Once upon a time there was a baby. He put a marble in his mouth. Later, he was *dee-lighted* to discover a marble in his mouth!

Of course the law *can* protect C, the bona fide purchaser, by working *via* B, the thief. The law *can* put a legal capacity in a thief, and then be delighted to find that that enables it to protect the bona fide purchaser.

But is it *sensible* that the law should move in this mysterious, circuitous way its wonders to perform? We think not. The law can do very nicely without the aid of the thief, thank you. *By judicial declaration, made for reasons of public policy, the law takes the title from A and vests it in C*. That is all there is to it. That thought is direct, frank, sensible, simple, wholesome. Send the fantastic notion of the law's using a thief as its instrument to shove the title along, — send that fantastic notion spinning, topsy-turvy, into legal space.

" Power " is a lusty, mouth-opening word, with a boom to it. There be those who love it. They pleasantly delude themselves into thinking that any position supported by a power theory is a powerful position. " Must that not," say they, " necessarily, in the nature of things, be so? Is not power power? " Experience with many thousands of students has led us to believe that usually the greater the use of the word " power," the smaller the power of the intellect.

What does the reader think of a person who says (1) that, in the cases on the sale of a negotiable instrument in negotiable form by a thief to a bona fide purchaser, he is convinced that the power theory is superior to the title theory; (2) that, *therefore*, in the cases on the assignability of a non-negotiable debt he is convinced that the power theory is superior to the title theory?

The author would donate a considerable sum of money to charity rather than to be under the necessity of expressing publicly, and in parliamentary but adequate language, what he thinks of such " reasoning."

Chapter IV

THE ASSIGNABILITY AT LAW OF DEBTS BEFORE DEFAULT

OF the four foundation chapters (II to V) this is the only one which does not tend to prepare for problems relating to Margin Customers. But, although that topic has been made the main topic of the book owing to its large practical importance and the numerous decisions thereon, yet there are other problems in the modern law of pledge which should be shown to a reader who desires to see the whole of that part of the law.

Chief among these other problems are problems arising when debt and security have been separated by a rascal pledgee, the debt going to one bona fide purchaser (or pledgee) and the security to another bona fide purchaser (or pledgee). The number of such cases is, as compared with the number of cases on Margin Customers, small; but such cases present some problems of definitely greater intellectual difficulty than those presented in Margin Customers cases.

If a reader is interested *only* in Margin Customers, we recommend that he omit this chapter and also Chapter XI. Possibly, it would have been a better arrangement to have had this chapter come directly before Chapter XI, but we thought that, all things considered, the four foundation, or background, chapters should come before we began the exposition of the modern law of pledge, which did not begin until 1863 (p. 196).

We put a simple case to show what is the problem discussed in this chapter on the assignability *at law* of debts *before* default. A is indebted to B. A is not in default, — if the amount is payable at a specified date, such date has not yet come, or if the amount is payable at B's demand or call, such demand or call has not been made. B wishes to sell A's debt to C. Will the law permit that?

If, say, A has made a promissory note payable to B or order (and such note conforms to all formal requisites for a negotiable

instrument), B may indorse the note and deliver it to C, and, if later A does not duly pay, C may maintain an action against A in C's name. The law recognizes that it was quite all right for B to substitute C for himself as the owner of the note *at law* (" law " being contrasted with " equity "). This is such a commonplace today that it may surprise some readers to know that at the close of the seventeenth century Lord Holt had a dispute with the merchants of the City of London over this, and that he ruled against the assignability of a promissory note even if it was expressly made to B or order. When pressed to confirm the custom of merchants on this point, he is said to have exclaimed in a huff: " It is not for Lombard Street to give the law to Westminster Hall." But the merchants were aroused, Parliament intervened, and the custom of merchants became law by force of a statute.[1] Even after that there were some problems about the assignability of negotiable instruments, but for almost two centuries it has been unquestioned law that a debt evidenced by a negotiable instrument (a first-class debt, p. 22) is assignable at law before default.

(Throughout this chapter we do not discuss the assignability at law of debts *after* default. The reader should not assume that we think that default by A necessarily destroys B's authority to assign. In some cases, yes; but in some cases, no. That is a long story, and, for the sake of keeping the issue crystal-clear we consciously refrain from discussing assignability of debts, unless at the time of the act intended to be an assignment by B to C, A is *not* in default to B).

Therefore the question becomes this: Is a debt *not* evidenced by a negotiable instrument assignable at law before default? Such a debt may be evidenced by a non-negotiable instrument, as when A makes a note payable to B (but does not say " B or order " or " to the order of B "), or when A gives B an informal I.O.U. A debt evidenced by a non-negotiable instrument is classified as a second-class debt (p. 22). Or such a debt may not be evidenced by anything in writing signed by A. Thus if A buys at a shop and the amount of the purchase is charged to A on B's books, such book debt is classified as a third-class debt (p. 22).

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[1] 3, 4 ANNE, c. 9 (1704).

Now, some persons with an inclination to compromise take the position that second-class debts should be assignable, but that third-class debts should not be assignable. We, however, urge *totis viribus* that *all* three classes of debts should be assignable *at law* (contrast equity) before default.

What does assignability mean? We use the three words " assignability," " transferability " and " alienability " as synonymous. But " assignability " should be sharply contrasted with " *negotiability*." Grasp that, or you are lost. Negotiability is assignability, *plus*.

A owns a negotiable note which is in negotiable form; B steals it and sells it to C, a bona fide purchaser; C wins over A. But if the promissory note had been non-negotiable, A would have won over C.

Again. B indorses a negotiable promissory note made by A to the order of B and sells it to C; A defaults, C sues; A alleges and proves that B secured the note by fraud; nevertheless C wins; the defense would have been good against B but it is not good against C; C stands *better* than B. But if the promissory note had been non-negotiable, A would have had a good defense against C, C would have stood no better than B, he would have stood in B's shoes.

Nota bene that we contend only that a second-class or third-class debt should be *assignable* (not negotiable), — our point is only that, if B desires, he may put C in B's shoes.

There is no question but that business men think of second-class and third-class debts as assignable. True, it may be bad for B's credit if he assigns, say, book debts. Business men dislike very much to find themselves in a position where they must do that to raise cash, but we never met a business man who did not assume that, if he wished to sell book debts, *of course* that was all right as a matter of law.

A second-class or third-class debt lies in the mind of the business man as just one species of property. Take the balance sheet of a large merchandizing corporation. Among the assets, there will probably be (1) some items as to land; (2) some items as to chattels, — stock on hand; (3) some item as to notes receivable

(first-class debts) and (4) some item as to accounts receivable (third-class debts). We do not believe that it ever occurred to any merchant that, although it was lawful for him to sell items (1), (2), and (3), it was not lawful for him to sell item (4) so as to substitute the purchaser in his place as legal owner. He takes it for granted that what a man owns outright he may sell if he pleases.

Now, the thought of Mansfield (see the description of him at p. 91) was that in any business matter the court should first inform itself as to what are the customs, usages, understandings of business men; and then should confirm those customs, usages, understandings *unless* there was some good reason to the contrary. The business view was enough to make a prima facie case, and, while the business view was not hedged with finality (Mansfield never took his hand off the helm), the prima facie case could be rebutted only for good cause shown (p. 91).

We ask the thoughtful reader to assume, at least for the moment, that the Mansfield approach is the proper mode of approach. Then the question becomes this: Is there any good reason why the courts should not confirm the understanding of business men that second-class and third-class debts are assignable at law before default?

Most readers will, we think, be surprised to learn that no less than five objections to confirmation have been made. We will outline each of these five and then discuss each at some length.

Objection No. 1. *Plantagenet.* The Plantagenet judges (1154–1485) could not conceive how anything that could not be possessed could be assigned. Only visible, tangible things (land and chattels) could be possessed; a promise was not a visible, tangible thing; therefore it could not be possessed; therefore it could not be assigned. Unquestionably, at the dawn of the common law no contract right, broken or unbroken, could be assigned.

Objection No. 2. *Maintenance.* The thought is that since, if A should *later* default, C might have to resort to a law suit to collect, an assignment from B to C was contrary to public policy owing to its tendency to swell the volume of litigation. For about three and a half centuries (1500–1850) this was the *only* objec-

tion *mentioned* by jurists. Neither Coke (p. 51) nor Blackstone (p. 59) mentioned any other objection.

Objection No. 3. *Personal relationship.* The thought is that, if A made a promise to B (without more), the personality of B was built into the very structure of the promise, and that "you cannot make a promise to Richard Roe out of a promise to John Doe."

Objection No. 4. *Stare decisis.* The thought is that, considering the many decisions and dicta that a second-class or third-class debt is not assignable at law even before default, this should be treated as settled law unless and until the legislature puts it right. Reason or no reason, follow the precedents. If, as a matter of sense, the law ought to be changed, pass the buck to the legislature.

Objection No. 5. *Williston* (for description, see p. 79) believes that it is to the *advantage* of business men themselves to treat second-class and third-class debts as assignable, even before default, *in equity only.*

Objection No. 1. *Plantagenet*

From 1154 to 1485 the common law judges served Plantagenet Kings of England. The Plantagenet judges, not unlike children, were chiefly interested in what appealed to their senses, — objects, things, *res,* which they could see with the eye and touch with the hand and foot. Such *res* were divided into two parts: Land was an immovable *res;* a chattel was a movable *res.* (In very early days cattle were the most important species of movable things; *catel* and *chatel* were old words for cattle; and in the course of time *all* movable *res* came to be called chattels.)

The Plantagenet judges had no difficulty about allowing the assignability, transferability, alienability of land or chattels. If A owned a cow and wished to substitute B in his place as owner, all he had to do was to transfer *the possession* of the cow to B, with intent to transfer the ownership. Similarly, if A owned an estate in fee simple in Blackacre and wished to substitute B in his place, all he had to do was to make livery of seisin of Blackacre to B, with intent to substitute B for himself.

There was no mysticism about " livery of seisin." That expression meant simply " delivery of the possession." It is true that " seisin " in later times became a word of art, but it was good old Plantagenet for " possession."

With respect to " livery of seisin " or " feoffment " (synonymous expressions) there is one specific point worth mention. A feoffment was valid even if there were no written evidence thereof until the passage of the Statute of Frauds in 1677.[2] Nevertheless, many prudent feoffees desired written evidence, for facility of proof, and frequently the feoffor delivered to the feoffee, together with the possession of the land itself, a " charter of feoffment " in which was set forth the extent of the land conveyed, the estate created, and so on. A usual way of making a feoffment was to sever something — a twig or piece of turf — from the land itself, and to hand that over (both feoffer and feoffee being on the land, or at least within view of the land) as a symbolical delivery of the land itself. Now, if the feoffor, instead of handing over a twig or piece of turf, handed over the charter of feoffment " in name of seisin " that was a valid feoffment. In a word, delivery of the land *could* be made by delivery of a document " if he deliver the deed upon the land in name of seisin of all the lands contained in the deed." [3]

But suppose that the state of the title of Blackacre was not just " A in fee," but that the state of the title was " B for life, with a reversion in fee to A," or that the state of the title was " B for life, with a vested remainder in fee to C," and that A or C (as the case might be) wished to transfer his *future* estate to D. Was a *future* estate *presently* transferable? A or C obviously could not transfer the possession of Blackacre, since B was in possession; but even the Plantagenet judges (from a date which it is difficult to fix with precision) did allow A or C *presently* to transfer the *future* estate. They allowed, *on a condition*, the delivery of a grant (or, as we should say today, a deed) to be a substitute for the delivery of the land itself, and the *place* where the delivery of the grant was made was immaterial.

The " condition " is the interesting point. The transfer was

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[2] 29 Car. II, c. 3.

[3] Co. Litt. 48a.

not effective unless A or C (note that the law was just the same for vested remainders as for reversions) could induce B to come into the picture and give a possessor's benediction (usually called "attornment") to the transaction.[4] The Plantagenet judges just could not get away from the idea that at least *some dealing with the possession of a visible, tangible res was an indispensable ingredient to make a transfer.* As well try to make bread without yeast, or beer without malt.

It necessarily followed that *no* contract right was assignable. A made an enforceable promise to B. B wished to substitute C in his place as owner of the obligation so created. The Plantagenet judges absolutely balked at that. As to the transfer of future estates in land, we think that they were troubled (probably much troubled), but they *did,* eventually at least, surmount *that* difficulty. That was not too much for them. But could the benefit of a *promise* be transferred? Certainly not. You could not see a promise. You could not touch a promise. You could not take possession of a promise. Nobody could, *in the nature of legal things,* have possession of a promise. Therefore, since they postulated that some dealing with the possession of a visible, tangible *res* was an absolutely indispensable ingredient to the making of *any* transfer, it inevitably followed that *no* contract, broken or *unbroken,* was assignable.

We not only concede, but urge *totis viribus,* that in order to understand what the common law of property is today we *must* go back to the Plantagenet judges, and become adequately informed about their conceptions. The common law is a growth, and its beginnings are Plantagenet conceptions. Those conceptions have had an *enormous* influence, — an influence the force of which is rarely appraised at an adequately high figure. Let no reader forget that the Plantagenet conception — the conception with which the common law began — was that *some dealing with the possession of a visible, tangible res is an absolutely indispen-*

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[4] There was necessity for attornment only in case the transfer was by a common law grant. *Cf.* a deed operating under the Statutes of Uses and Enrolments. Even as to a common law grant, the necessity for attornment was abolished in 1705 by 4 & 5 ANNE, c. 16, § 9.

sable element of any assignment. "Nothing which cannot be possessed can be transferred." Let each reader look squarely in the face the fact that that conception, primitive though it may be, crude though it may be, was unquestionably the *beginning* of our law on assignability, transferability, alienability.

And before leaving the Plantagenet judges, there is something more to be said which we regard as very important indeed. The Plantagenet judges have exercised a great influence upon later judges by a *nomenclature* which they adopted.

They introduced the caste system into rights. There were possessory rights, — the patrician rights; and there were "other" rights, — the plebeian rights. Rights based on possession, and rights not based on possession, — the world of rights was divided into these two parts. Rights not based on possession were called "choses in action" (*action* being contrasted to *possession*). The expression "choses in action" had a connotation of contempt; such rights did exist but they did not "belong." They were *οἱ πολλοί*.

There are those who think that the term "chose in action" relates exclusively to contract rights. That is very, *very* wide of the mark. A reversion in real property was a "chose in action" to the *early* (not the later) Plantagenet judges, and Dean Ames to his death fought like a Crusader for the doctrine that a reversion was only a "chose in action."[5] The right of a disseisee was a "chose in action." A right of entry for condition broken was a "chose in action." A contingent remainder was a "chose in action." The right of a *cestui que trust* was, according to the *common law* judges, a "chose in action." An advowson was a "chose in action." It was not until 1844 that it became clear that a bailor's right in a chattel was not a mere "chose in action"; Baron Parke, at Nisi Prius, actually ruled that a pledgor's interest in a chattel was a chose in action, (and he *also* ruled that it was on that account unassignable).[6] A right to sue a tortfeasor was a

[5] 3 Harv. L. Rev. 337.

[6] *Franklin v. Neate,* 13 M. & W. 481, 14 L. J., Ex. 59 (1844). This ruling was reversed by the court *in banc.* The opinion was by Baron Rolfe. Baron Parke did not dissent.

"chose in action." A bond was a "chose in action." A share of stock was a "chose in action." A covenant was a "chose in action." A contract was a "chose in action." A patent was a "chose in action." A copyright was a "chose in action." The good will of a business was a "chose in action."

Never since that rainy morning when Noah lead the way into the ark with his jostling, variegated followers have so many heterogeneous things been crowded into the same boat.

Bewildering, *until* we remember that the Plantagenet judges, who worshipped the God of Possession before all other Gods, had divided rights into possessory rights, and "other" rights, and had dubbed all rights, other than possessory rights, "choses in action." "Mere" choses in action was the idea. The significance of "choses in action" was a purely *negative* significance, — they were rights which were *not* within the patrician circle, they were outsiders.

We make the point at once that it is not reasonable to make one sweeping rule of law as to assignability which shall be ruthlessly applied to every one of these heterogeneous elements. And it is *demonstrable* that the law has *never* been that *all* these heterogeneous rights were unassignable. One example. Littleton,[7] one of the last of the Plantagenet judges, treated it as clear law that an advowson lay in grant.[8]

The persistence of the Plantagenet conception as to assignability

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[7] Sir Thomas de Littleton, 1402–1481; Recorder of Coventry, 1450; King's Serjeant, 1455; Justice of Common Pleas, 1466; Knight of the Bath, 1475; published his treatise on Tenures about 1481. This treatise was the first printed treatise on the common law, coming just three centuries after Glanville's treatise, which was the first treatise on the common law (p. 10, note 1). This treatise was the subject of a Commentary by Coke (p. 52), and we regard Coke on Littleton as the most influential treatise on the common law that ever was written, and we doubt if any other treatise will ever have anything like so great an influence on the common law.

[8] Tenures, § 617. An advowson was the right of presenting a fit person to the bishop having jurisdiction to be by him admitted to a benefice which had become vacant. It was included under the term "real estate" by 1 VICT., c. 26, § 1. Coke called an advowson a "chose in action," 90a, but nevertheless, thought of it as usually assignable (if, however, there was a vacancy, assignment might savor of simony, — in one aspect an advowson was a spiritual trust). Some of the passages in his Commentary upon Littleton in which he speaks of an advowson are at 17b, 85a, 90a, 120a, and 332a.

is amazing. This leads us to speak of Dean Ames. We are in a quandary as to what is seemly. In student days, the author derived a great deal from him, — he was extraordinarily stimulating, thought-provoking. The author has never seen reason to question the soundness of the fundamentals in the exposition by Dean Ames of the law affecting negotiable instruments, or of the law affecting trusts. And in the law of property it was fascinating to follow his historical researches; he was like unto a man who with flaming torch explores dark, forbidding caverns. But much of what Dean Ames taught on the law of property now seems to the author to be plainly wrong. He has hesitated to say that. But truth is no respecter of persons, and he has decided to say it, because he believes that, if Dean Ames were now alive, he would say: " If you do differ from me, *of course* speak out." He would have taken the propriety of that in his stride. There never was a man who more perfectly lived up to the ideal: " Think, and let think."

Our criticism of Dean Ames is that he not only went back to the Plantagenets (as everyone should), but that he *stayed* with them. We believe it to be true that, on questions of the law of property, his spiritual home was with the Plantagenet judges, — and with the *early* Plantagenet judges at that.

He actually said that a reversion in land was not assignable.[9] His thought was that a so-called transfer of a reversion was not a transfer, but a novation. For example. A leases to B. A " transfers " his reversion to C by common law grant. B attorns. B now holds of C, instead of A. That, said Dean Ames, was a novation; B had stood in a certain relation to A; he now stands in the same relation to C; one relationship, a B-C relationship, has been created, and another relationship, an A-B relationship, has been terminated.

If such a case were the *only* one requiring consideration, we concede that the " transfer " of a reversion could be so explained away. But it is *not* the only one. Dean Ames apparently overlooked the fact that attornment was *not* necessary, where the conveyance of the reversion was by some method other than a common law grant, — for example, by deed of bargain and sale

[9] 3 Harv. L. Rev. 337. " A reversioner could not convey his reversion."

The true portraiture of Iudge Littleton the Famous English Lawyer

operating under the Statute of Uses, and enrolled pursuant to the Statute of Enrolments. He also overlooked the fact that attornment was just as necessary in case of a vested remainder as in case of a reversion. Thus if A, a great lord, conveyed to B in fee, and B conveyed to C for life with vested remainder to D in fee, and D wished to transfer his vested remainder to E by common law grant, C's benediction was necessary. In such case, attornment cannot be likened to a part in a novation, for there is no tenure between life tenant and remainderman, but, on the contrary, both life tenant and remainderman hold under A, the great lord, by force of *Quia Emptores*.[10] C is not now holding from E in place of D, for C never held of D.

We can readily understand how a person who has done historical research may be so impressed with the value of what he has found, showing what the law *was* in the past, that he inclines, and strongly inclines, to think that it follows that such old law *ought to be* the law *now*. Thus, Dean Ames ended his famous articles on the Disseisin of Chattels, and the Inalienability of Choses in Action in these words: "In conclusion, then, the ancient doctrine of disseisin of land and chattels was not an accident of English legal history, but a rule of universal law. Brian's dictum, that the wrongful possessor had the property and the dispossessed owner only the right of property, rightly understood, is not a curiosity for the legal antiquarian, but a working principle for the determination of controversies *for all time*."[11] (Italics supplied).

Possibly, there are other jurists, on or off the bench, whose spiritual home is with the early Plantagenet judges, or at least with the later Plantagenet judges. If so, they will not agree with our conclusions in this chapter, for it certainly was the Plantagenet conception (early *and* late) that some dealing with the possession of a visible, tangible *res* was an absolutely indispensable ingredient to the making of *any* assignment.

We think that the number of such persons is not very large. The possibility that there may be a few is not disturbing. What is disturbing, and mightily disturbing, is that we verily believe that *thousands* of persons, well trained in the law, have that

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10 18 Edw. I, c. 1. (1290). 11 3 Harv. L. Rev. 345.

Plantagenet conception, not in their consciousness (as Dean Ames did), but in their subconsciousness.

The author, as a young man, sat at the feet of four wise men of Harvard, — Charles Franklin Dunbar, William James, James Bradley Thayer, and John Chipman Gray. In 1893, he heard William James say something, the idea of which was about as follows: " The subconsciousness moves swiftly and painlessly. The consciousness moves by the slow and painstaking processes of reasoning. A *conclusion* is usually a child of the subconsciousness, — not of the conscious, reasoning mind. The consciousness simply throws a garment of reasoning about the newborn child to guard and preserve it. The subconsciousness is the mother, the mistress; the consciousness is the nurse, the servant. Life is given by the subconsciousness; death is averted by the consciousness." And he also said something about as follows: " If the consciousness becomes aware of some undesirable, unreasonable thing in the subconsciousness, the consciousness must plunge into the subconsciousness, grasp that undesirable, unreasonable thing, bring it to the surface, and expose it to the sun of reason. If that be done, it will soon wither away."

We think that both such statements are true and that their importance is not duly recognized. And we repeat that we believe that there are *thousands* of persons well trained in the law that have this Plantagenet conception, not in their consciousness, but in their subconsciousness. Every adequately trained lawyer knows that our law is a growth; that, in order to understand it, we must first see clearly from what beginnings it grew; that the beginnings were Plantagenet conceptions; and that the Plantagenet judges laid *enormous* (no lesser word is adequate) importance upon possession, so that it was almost literally true in their time that possession was nine parts of the law. When a student has been trained to work up from Plantagenet concepts, those concepts, even if later ousted from the consciousness, may, and very frequently do, find a refuge in the subconsciousness. We have again and again discussed problems on assignability with persons who we believe illustrated the thought of William James, — they reached their conclusions because of this Plantagenet con-

ception in their subconsciousness (denying with some warmth that it was in their subconsciousness), and then sought to *rationalize* their conclusions by some reason *different* from the Plantagenet reason. (To prevent any possibility of misunderstanding, we wish to say that Williston is not one of those persons; there is no difference whatever between him and the author as to Objection No. 1.)

We ask the reader to pause, ponder, probe his mind. Is that Plantagenet conception — the conception that some dealing with the possession of a visible, tangible *res* is an absolutely indispensable ingredient in assignability — *is* that conception in his subconsciousness? If so, *what is he going to do about it?* Is he going to lift it into his consciousness and rejoice in it, as Dean Ames did? Or is he going to lift it into his consciousness for the William James purpose of having it wither away before the sun of reason?

We conjecture that nine out of ten of our readers who have studied in any law school have that Plantagenet conception in their subconsciousness. Unless a reader will, and can, bring it to the surface, and let it wither under exposure to the sun of reason, we recommend that he close this book. Let us part, as the best of friends, *but,* let us part.

Objection No. 2. *Maintenance*

Until about a century ago, the only objections urged against assignability were either the Plantagenet objection or the maintenance objection. To what extent the Plantagenet objection was in the subconsciousness of Coke and Blackstone is largely matter of conjecture; we conjecture that it was in Coke's subconsciousness but was not usually operative, and we feel pretty sure that it was in Blackstone's subconsciousness and was quite frequently operative and decisive. But the only objection to assignability *mentioned* by either Coke or Blackstone was the maintenance objection.

Just what is the maintenance objection?

At the dawn of the common law the "better" men were those with the better mailed fists. Now, suppose that B is suing C be-

fore judge and jury, and A, a great lord, with a dominating influence in the neighborhood, sweeps into court with his retainers, grasps B's hand, makes it plain to all and sundry that he wants B to win. That was maintenance. A was maintaining, helping out B.

The judges, to their credit be it said, were bitterly opposed to that sort of thing, and they laid down a general rule that no one should help a litigant. They made some exceptions to this rule and they should have made more (it was, for example, at one time the law that if any person who had not been subpoenaed *voluntarily* gave testimony, he was guilty of " maintaining " the litigant who was helped by his testimony). But the establishment of the general rule should be recognized and highly valued as a first groping toward the democratic ideal that all men shall stand equal before the law, — that the law shall be no respecter of persons.

The reader will note that originally " maintenance " had nothing to do with assignability. That came later. Suppose that instead of helping B out A *bought* B out. That was even worse. It was another way in which a happy legal warrior got into action, and the courts were determined to squelch that kind of person. Therefore, they brought the big stick down, and brought it down hard. They made an inflexible rule that no *cause of action* could be assigned, — in other words, that no law suit could be sold. We believe that for centuries this was clear law, and that the courts were hard as granite against allowing *any* exception to the principle that no *cause of action* could be assigned.

Now, the cause of action which occupied the center of the stage right down to Coke's day was the disseisee's right. Today contract questions absorb a very large proportion of the time of courts, but that is definitely modern. Glanville (p. 10, note 1) was not much interested in contract, — indeed, he said that debts of the laity were not a fit matter to be brought into the King's Court; [12] land law, as contrasted with business law, held the center of the stage in Coke's day and in Blackstone's day (p. 59); and even today there be those who attach enormous importance

[12] Laws and Customs of the Kingdom of England, Book X, Chap. XVIII.

to the intricacies of medieval real property law (and certainly it is a topic fit to delight the intellectual gymnast).

Now, in medieval times, the disseisor seems to have been quite a favorite at courts of law. A enfeoffs B in fee of Blackacre. C comes along, and, without a shadow of right, ousts B and claims the fee. Believe it, or believe it not, the law in medieval times was that C, the disseisor,[13] *forthwith* had the fee of Blackacre, and that B, the disseisee (the person who today would be popularly called the owner), was out on the legal foot path with nothing but a "right of entry," — enforceable either by action (court-help) or by entry (self-help).

Why a disseisor should have been such a favorite at courts of law, we do not fathom. The Plantagenet judges were very strong for the principle that an existing possession must be respected, and they carried to great lengths the idea that in the triangular cases where A was the owner, B the possessor, and C the wrongdoer, B's rights against C were greater than A's rights against C (see p. 149). Nevertheless, in a number of ways they favored the disseisor (the disturber of an existing possession) against the disseisee. Possibly the explanation of this cross current is that the great lords were interested to have as tenants lusty men who could pay good rent in fighting services; that therefore they were in favor of "experimenting" and letting the best man win; and that their wishes influenced the thoughts of the judges. However that may be, it is perfectly plain that in medieval times both the courts and Parliament were cold to the disseisee.

Suppose B was tenant in fee simple of Blackacre and C ousted him without right and claimed the fee. A, the great lord, would do nothing about it. What could B do? He could do one of three things: First, he might seek to regain the possession by self-help; that would not be attractive if C were the "better man." Second, he might bring an action to establish his right and to have the proper officer of the court put him into possession; B might shrink

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[13] Do not confuse the medieval doctrine of disseisin with the modern doctrine of adverse possession. For the similarities and dissimilarities, see 88 U. of P. Law R. pp. 903–5. For the precise way in which title is acquired by adverse possession continued for a long period of time, see p. 86, note 137.

from the burden and expense of the litigation and the manifestations of C's hostility. Third, he might sell his right to someone else. So he looks around and finds a likely purchaser in D.

Right there the judges stepped in. They were adamant against B's selling to D, but favored his selling to C (and so "composing differences," and "quieting estates"). B had legal capacity and authority to *release* to C, but B had neither legal authority nor capacity to *assign* to D. The disseisee's right was releaseable, but not assignable.

Therefore, it boiled down to this: B must either take on a fight with C (out of court or in court) or must sell out to C at C's price. *C was the only market B had for B's claim against C.* This was fine for C.

Is such a rule worthy of support in modern times? It is true that Dean Ames supported this rule, and even declared that it was necessitated by something in the nature of legal things.[14] It is also true that the New York Court of Appeals as late as 1902 [15] held that where B, the owner (as today he would popularly be called), was out of possession, and C was in tortious possession claiming to be owner, and B delivered a deed to D who recorded the deed, and later B delivered a deed to C (who knew of B's deed to D), C prevailed over D. The court nowhere spoke of disseisin (indeed, it spoke of B as having "the title") but, we submit, the result is unintelligible except as a throwback to the medieval law that the man out of possession had a something which he could release but could not assign.

We believe that that was a very unfair rule, and that at least it should have no place in modern law.

Very few persons, very few indeed, realize that the doctrine that *contract rights* were unassignable was a mere trailer to the thought that the rights of *disseisees* were unassignable. The rights of disseisees were unassignable, *therefore,* contract rights were un-

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[14] He even characterized as "unfortunate" a dictum by Mr. Justice Story that if B owned a *chattel,* and C seized it without right, B had a right which he could convey to D. 3 Harv. L. Rev. 344.

[15] *Dever v. Hagerty,* 169 N. Y. 481, 62 N. E. 586.

assignable. Contract rights were a mere " me too " to disseisees' rights.

This came about in the following way: Parliament was not content to leave the disseisee in the deep hole in which the judges had put him. It passed several statutes designed to hit him on the head if he even *tried* to get out of the hole. Not only was he stripped of legal capacity to assign, but, furthermore, if he made a move like an assignor, if he went through the motions and *purported* to assign, down on his head came the big stick of a *statute* subjecting him to a penalty for trying to do what the judges had made him incapable of doing.

The most famous of these statutes is one passed in the reign of Henry the Eighth.[16] If the reader will take adequate time (a couple of hours) to make a careful perusal of the text he will see that this statute had nothing whatever to do with the assignability of contract rights. It talks of land and nothing but land. The statute imposed penalties on three classes of persons: First, those who were out of possession of land, but claimed *without* any basis that they had the right to the possession and purported to sell that right. Second, those who were out of possession of land, but had a lawful right to gain the possession (disseisees, or owners as we should say today) who purported to sell that right. Third, those who interfered with the due administration of justice in any trial affecting the title to land. The disseisee was exposed to the suffering of penalties, with an out-and-out rascal on either hand.

This brings us to Coke (1551–1633) the most interesting figure in the common law. He was born in a small village in the county of Norfolk, attended the Norwich Grammar School, rapidly worked up and became Speaker of the House of Commons at a time when the Speaker occupied a position not dissimilar to the position of Tribune of the People in Roman days. He did not hesitate at times to oppose Queen Elizabeth, but she was big enough to make him her Attorney General. He was knighted, and became Sir Edward Coke (he was never made a peer). Much may fairly be said in adverse criticism of Coke as Attorney General; his

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[16] 32 HEN. VIII, c. 9 (1540).

conduct of the trial of Sir Walter Raleigh makes the modern reader wince. Later, he became Chief Justice of the Court of Common Pleas, and still later Chief Justice of the King's Bench, and, as such, Lord Chief Justice of England.

When James I was seeking to extend the scope of the royal prerogative he caused Coke to be sounded. If a certain point came before him, could His Majesty be assured of a decision in favor of prerogative? A copy of Coke's reply (or draft of reply) is still in existence in the library at Holcombe, the residence of one of Coke's descendants. " If such a question should ever come before me, I will attempt to decide it as in reason and right it ought to be decided." He was taking no orders. He was giving no assurances. A never-to-be-forgotten answer.

Naturally, Coke was not popular with His Majesty and time came when Coke was, for a period, a prisoner in the Tower of London.

Coke wrote several volumes of reports which were long known as *the* reports. He also in his old age wrote the Institutes of the Laws of England, the first part of which was his famous Commentary upon Littleton. (Littleton was about eighty when he wrote his treatise on Tenures, and Coke was about eighty when he wrote his Commentary, — let those who wish to snuff out the old men take notice.) The reports and the Commentary are stiff reading, — there is a headache or two in a majority of the pages. Mansfield called Coke " a crude and crabbed writer," and legend has it that a young man (eager to marry) who afterwards became Lord Chancellor Eldon sat up night after night assimilating Coke on Littleton, with his head swathed with wet towels.

Coke was a man of vast learning and with one of those dynamic intellects that comes along only at rare intervals. For centuries, the English bench and bar carried reverence for Coke so far that it may well have been a breach of the First Commandment. The author believes that Coke has had more influence upon the common law than any other man living or dead. He pictures Coke as leading the hosts of the common law, with stern brow, and penetrating eye, and rapier tongue, and juristic thunderbolts poised in either hand.

SIR EDWARD COKE
Lord Chief Justice of England

Now, did this most eminent authority say that a debt was unassignable at law even before default? He did not. On the contrary, he said that an annuity (an obligation to pay a sum of money from time to time over a period) *could* be assigned with respect to payments thereafter to become due (although the right to arrears could not be assigned), and that the assignee could in his own name maintain a writ of annuity (a remedy at law, not in equity) against the obligor if *after* the assignment the obligor defaulted.

Many, many persons are under the impression that Coke laid it down as clear law that no contract right broken or unbroken was assignable at law. He did not. He who relies on Coke as authority for the proposition that a contract right is unassignable at law even before breach is like unto a man that buildeth his house upon the sands.

What is the reason that so many thousands of persons have thought and still think that Coke was the very high priest of the doctrine that contract rights are unassignable at law (as distinguished from equity) even before breach?

The closet must be opened. The skeleton must be brought out. Coke, great man though he was, was guilty of lingual bigamy.

He used the expression "choses in action" in *two* meanings, and *widely* different meanings at that. There was a narrow meaning, and there was a broad meaning. The narrow meaning was *a cause of action;* a right to come *now* into a court to sue for what *is* due. The broad meaning was like the *οἱ πολλοί* meaning of the *later* Plantagenet judges, — "choses in action" covered *all* rights except (1) possessory rights in land or chattels, and (2) reversions, vested remainders and rents. Sometimes Coke dallied with the thin meaning and sometimes he dallied with the fat meaning, and his mental children have quarreled as brothers and sisters of the half-blood so often do.

He was emphatic that a *cause of action* ("chose in action" in the *narrow* sense) was unassignable. In speaking of the Statute of Henry VIII against maintenance (p. 51), he said: "If *A.* be disseised in this case, *A.* hath a good lawfull right; yet if *A.* being out of possession, granteth to, or contracteth for the land with

another, he hath now made his good right of entrie pretenced within the statute, and both the grantor and grantee within the danger thereof. *A fortiori* of a right in action. *Quod nota.*" [17]

Those nine words "*A fortiori* of a right in action. *Quod nota*" are the key to Coke's mind on this matter. Grasp that key.

It is plain that Coke was thinking of cases where some person has a right *now* to come into a law court and seek what is due to him. He elsewhere defined "action" as follows: "*Actio nihil aliud est quam jus prosequendi in judicio quod sibi debetur.* Or, *Action n'est auter chose que loyall demande de son droit.*" [18] Nothing else but.

There are some other passages that demonstrate that when Coke said that a thing in action or a chose in action was unassignable he was thinking of a *cause of action.* Thus, in *Lampet's Case,*[19] we find the following: "And first was observed the great Wisdom and Policy of the Sages and Founders of our Law, who have provided, that no Possibility, Right, Title, nor Thing in Action, shall be granted or assign'd to Strangers, for that would be the Occasion of multiplying of Contentions and Suits, of great Oppression of the People, and chiefly of Terr-Tenants, and the Subversion of the due and equal execut. of Justice." And in the Commentary upon Littleton he said: "And it is to be observed, that by the antient maxime of the common law, a right of entrie, or a chose in action, cannot be granted or transferred to a stranger, and thereby is avoyded great oppression, injurie and injustice. *Nul charter, nul vende, ne nul donc vault perpetualment si le donor n'est seisie al temps de contracts de 2. droits, si del droit de possession, et del droit del propertie.*" [20]

"A right of entrie, or a chose in action, cannot be granted or transferred to a stranger." His thought would have been expressed with greater precision if he had said that a right of entrie or *any other* chose in action could not be granted. And we submit that it is quite plain that here he was using the expression "chose in action" as equivalent to "action" which he had defined as the right *now* to come into court for what is due. In a word, these

[17] Co. Litt. 369a.

[18] *Ibid.,* 285a.

[19] 10 Co. at p. 48.

[20] 266a.

passages show that Coke was strong against the assignability of a cause of action (chose in action in the *narrow* meaning) but there is nothing to justify the statement that he denounced the assignability of every species of those rights which had been contemptuously lumped together and dubbed "choses in action" by the Plantagenets (p. 42).

The disseisee had a right at the present moment forthwith to come to court to enforce his claim. He had a cause of action. The doors of the court stood open to him; he could enter into litigation *now*. The disseisee was, in those days, *facile princeps* among those entitled to enter the lists of litigation.

If a person having so important a cause of action as did a disseisee could not assign it, *a fortiori*, any other person having a cause of action could not assign it. That is the pith of the whole matter.

If the chose in action *par excellence* was unassignable, then *a fortiori* as to lesser choses in action. There is precedence even among plebeians. Like leader, like follower. Lesser causes of action were, *a fortiori*, unassignable.

But more. Not only did Coke never say that no "chose in action" in the *broad* sense was assignable, but he did expressly say that three different species of "choses in action" in the broad sense *were* assignable.

1. He called an advowson a "chose in action" but it never occurred to him not to follow Littleton's statement that it was usually transferable by grant (see p. 43). He took it quite in his stride that *that* kind of a οἱ πολλοί "chose in action" was assignable.

2. He said that a warranty (note that this is a *contract* right) was assignable at law *before breach*. B enfeoffs C in fee of Blackacre, and warrants the title, the warranty being expressed to be in favor of C, his heirs and assigns. C enfeoffs D. A, having title paramount, ousts D. D may *in his own name* sue B *at law* on the warranty. Here, then, is a case where even a *contract* right was assignable at law before default.[21]

3. He said that an annuity was assignable. He defined an an-

[21] Co. Litt. 384b.

nuity as follows: "An annuity is a yearly payment of a certaine summe of money granted to another in fee for life or yeares, charging the person of the grantor only. But not only the grantee, but his heire and his and their grantee also shall have a writ of annuity." [22]

Now note that. *Nota bene.* He was *not* speaking of a rent charge created without transmutation of possession. Here was a right *in personam* unbuttressed by any right *in rem.* It charged "*the person of the grantor only.*"

Coke was fully alive to the distinction between broken and unbroken contract rights. He shows that by a passage in which he differentiates releases of unbroken covenants from releases of broken covenants.[23] In dealing with annuities he makes the distinction between *broken* and *unbroken* decisive as to assignability. The annuity was assignable but arrears were unassignable. Note the distinction. Once the obligor defaults, the cause of action on the default is not assignable. That would be selling a law suit, — it would be maintenance. But, *before* default, the contract right *was* assignable, and assignable *at law.*

It may be asked: Did not Coke when saying that an annuity was assignable have in mind *only* an annuity which had been expressly created in favor of the obligee, the annuitant, *and* his heirs and assigns?

We believe that Coke made this statement without any such mental reservation. There are three circumstances leading to that conclusion each of which has large persuasive force:

(1) In discussing warranties,[24] he did restrict his statement as to assignability to a case where the warranty had been made in terms to the feoffee, his heirs *and assigns.* He did *not* restrict his statement as to the assignability of an annuity to a case where the annuity had been created in favor of the obligee, his heirs and assigns.

(2) He had reported a case, *Maund's Case,*[25] where an annuity had been created in favor of the obligee, his heirs *and assigns,* so that he was perfectly familiar with that sort of thing. Yet in

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[22] *Ibid.,* 144b.
[23] *Ibid.,* 292b.
[24] *Ibid.,* 384b.
[25] 7 Co. 28b.

the Commentary he does *not* restrict his statement to such an annuity as had been before the court in that case.

(3) In *Spencer's Case*,[26] the judges had spoken at length of diverse diversities. True, in that case the judges were considering whether the *burden* (contrast benefit) of a covenant ran with the land, but they examined at length the question whether it made any difference whether the original covenantor had, or had not, made the covenant in behalf of himself *and assigns*. Sometimes, they concluded, it made no difference; but sometimes, they concluded, it made all the difference. It is not reasonable to suppose that Coke, with his restless, inquiring, elaborating mind, did not have before him the possibility that, in determining whether the benefit of a promise ran, the use of (or failure to use) the word " assigns " might not be decisive. In discussing topics in the Commentary, he again and again covers *every* possibility. His comments are full. He relished, dearly loved a " diversity." If he thought the law was one way when the annuity was expressly made in favor of assigns, but was the other way when no mention of assigns was made, it is ten to one that he would have said so.

Each of these facts is persuasive. Combined, they make a very strong case for concluding that he did *not* consider that the use of the word " assigns " was indispensable to the assignability of an annuity.

A creates an annuity in favor of B. He obligates himself to pay a defined sum of money, say, once a year for four years. The annuitant could assign his right *at law before default*. Then why should there be any difficulty about assigning a right to a single payment of a defined sum of money in four months? Why does not the greater include the less? Is there any peculiar virtue about a writ of annuity which enables it to perform wonders? Certainly Coke did not rely on any such reasoning.

We searched with special care to find all statements made by Coke which might throw any light upon his conception of the assignability of *unbroken* contract rights. It may well be that we missed something, but we found only four. Two of the four

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26 5 Co. 16a.

(warranties and annuities) have been mentioned above. Of the other two we feel pretty sure that one was a statement intended to apply only to *broken* contracts. The other was a statement as to what rights in the wife's property the law gave to the husband on marriage. We think that there is nothing in either of these statements which weakens what we have said above. But we do not ask the reader to take our word for it. The other two statements are given in Appendix A.

And now at long last does the reader see how it came about that so many persons have thought (and still think) that Coke laid it down as clear law that no contract right, broken or *unbroken,* was assignable at law?

Coke is, no doubt, largely responsible, because of his indulgence in lingual bigamy. (1) He did call *a cause of action a* " chose in action " (the narrow meaning); (2) he did say that *no cause of action* is assignable; and (3) he did sometimes call an unbroken contract right a " chose in action " (his broad meaning, equivalent to the late Plantagenet meaning). Unless you watch your step, you will slip into thinking that there was a 4, corresponding to the 2, — that a " chose in action " in the *broad* sense was as unassignable as a " chose in action " in the *narrow* sense. But the pith of the whole matter is that it is demonstrable that *there was no 4* in Coke. And it is for a 4 that Coke is supposed to be the high authority.

We will conclude the exposition of the lack of justification for citing Coke as authority for the unassignability at law of an unbroken contract right by putting two syllogisms (or alleged syllogisms).

First syllogism: 1. Every murderer is a sane human being. 2. Every murderer should be hanged. Therefore, 3. Every sane human being should be hanged. Obviously absurd. Because *one* species of the genus has a quality it does not follow that *all* species of the genus have that quality.

Second syllogism: 1. Every cause of action is a " chose in action." 2. Every cause of action is unassignable. Therefore, 3. Every " chose in action " is unassignable. But that is equally absurd. Because *one* species of the genus " chose in action " lacks

a quality it does not follow that *all* species of the genus lack that quality.

Or, to put it in another way. It does not at all follow because a "chose in action" in the *narrow* meaning of a cause of action is unassignable, that every chose in action in the *broad* meaning is unassignable.

And never forget that the unassignability of a contract right *even after default* was just a trailer to the unassignability of a disseisee's right. The author, in discussing this matter of the assignability of contract rights years ago with a member of a law faculty (not Williston) who offered a course in contracts, once said: "The assignability of contract rights is today still staggering under the load of the old man from the disseisin days on its back." He replied: "I have not the slightest idea what you are talking about. Disseisin is a topic which has not, and never had, any relation whatever to contract law."

The author was silent both in Norman French and English.

We pass to Professor Sir William Blackstone (1723–1780). As a young man he earned at Oxford the degree of Doctor of Civil Law, and he was sometimes mentioned as "Doctor Blackstone" by early American lawyers. Later, Oxford made him her first professor of law. In his opening lecture he sought to justify the emergence upon the English stage of that strange cosmic phenomenon — a law professor. His Commentaries are, at least in the main, lectures which he delivered at Oxford. The publication of the first edition was completed in 1769. In the following year he was made a Justice of the Court of Common Pleas, and was knighted. He served as a Justice until his death, ten years later.

If one considers English as well as American law, and the whole period of time which elapsed between Coke's being admitted to the bar and the present time, we think Coke has had more influence on the common law than any other one man (p. 52). But we think that Blackstone had more influence than any other one man on *American* common law *in the period between the Revolutionary and Civil Wars.* The reasons for that were as follows:

The colonists prized English common law as part of their heritage. They firmly believed that "No taxation without representation" was a common law principle. They revolted, not against English law, but against the flouting of that law by a stupid, stubborn, scarcely sane Sovereign. They did not desire to substitute French law for English law. They were accustomed to the common law and were content with it. Moreover, few lawyers knew any law except the common law; it was natural that they should wish to develop an American common law on the *foundations* of the English common law.[27]

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[27] In all the states which are within the bounds defined by the Treaty of 1783, the law stems from (a) English common law as it was in 1776; or (b) certain old English statutes in amendment of the common law which were incorporated into *American* common law; or (c) what may be called "indigenous" law, — law generated in colonial days by some colony on its own initiative. The Recording Act passed in 1640 by the Massachusetts Bay Colony is a notable example of "indigenous" law. The present recording system in Massachusetts stems from that 1640 act. It is demonstrable that that act was *not* drawn upon an English model. True, there had been a Statute of Enrolments (27 Hen. VIII, c. 16) passed in England about a century before, making enrolment a condition *precedent* to the validity of *one* kind of conveyance, — to wit, a bargain and sale of a freehold estate taking effect under the Statute of Uses. But the Statute of Enrolments gave no lead for the thought, which is the dominant thought of the present Massachusetts registry system, that recording is *not* a condition precedent to the validity of the deed between A and B, the grantor and grantee, — that the deed is, *without recording,* valid against A, his heirs and devisees, and also against subsequent purchasers or mortgagees with notice, but is invalid against subsequent bona fide purchasers or mortgagees from A, and that it is also invalid against the creditors of A. In 1640, England had no such act. Later, such acts were passed applicable to certain *parts* of England (England does not even today have such an act applicable to the whole of England), but the earliest of these local acts (the Bedford Level Act) was not passed until 1661 (15 Car. II, c. 17). Whether father copied son in the Bedford Level Act is matter of conjecture. And what were the sources of the Massachusetts Bay Colony Act of 1640 is also matter of conjecture. We have heard it suggested that the colonists were influenced by Dutch models, and that sounds plausible. If that can be *demonstrated,* then we should have an instance where even in the original territory of the United States the law stems from the Continent of Europe.

But the territory of the United States as defined in the treaty of 1783 is only about one-quarter of its present territory. In *all* the territory since added, whether by purchase, annexation, or conquest, the land had at some previous time been owned by Spain (or at least had been claimed by Spain under the Papal Donation), and Spain had been the first civilized nation (at least since 1492) to own any part of it. Therefore, in three-quarters of the present territory of the United States the

SIR WILLIAM BLACKSTONE

Justice of the Court of Common Pleas
Professor of Law at Oxford

But what *was* the English common law in 1776? It is to be remembered that in those days there were no law schools, no law professors. And there were no libraries containing all the reports to which judges and practising lawyers had easy access. Under these circumstances, Blackstone was the answer to a lawyer's prayer. His Commentaries were *just* what was needed. They were an exposition of the whole of the common law, written a few years before the Revolution (it was largely the timing that did it) and written by a person so learned in the law, and so qualified to administer it, that he had been doubly honored by being made the first professor of law at Oxford and by being made a justice of one of the principal courts. No wonder that our legal ancestors thought the Commentaries were manna from Heaven. Moreover, they were so readable; Blackstone set the law to music, cathedral music, — serene, sonorous, stately.

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underlying stratum of the law is Spanish law. "*Inter barbaros silent leges*," and perhaps this underlying stratum does not amount to much, but it is there, and occasionally crops up. Moreover, in all the territory acquired by the Louisiana Purchase, there is a second stratum, this second stratum being of French law. These facts have had important consequences. For example, in about a dozen of our states the law countenances "community property," the general idea being that the wife who keeps the house and brings up the children is entitled, not merely morally but legally, to half of what her husband acquires by effort. The thought is that she *earns* half of that. This method of holding property was known both to Spanish and French law, but was unknown to the common law. Curiously enough, this Creole chivalry has proved to be bread returning from the waters to federal-income-tax-paying husbands; for, under the federal income-tax laws (as they stand at the moment when this is written) a Massachusetts husband with a net income of $50,000, all earned, pays *eight* dollars in federal taxes for every *five* dollars which a California husband *and* his wife pay, if his professional or business income is $50,000.

Moreover, in Louisiana there is a good deal of law which stems from French law. True, crimes are statutory, and there are statutes modelled on English statutes (see 33rd Section of the Act of May 4, 1805 and *State v. Lacombe,* 12 La. Ann. 195). True, some uniform statutes like the Negotiable Instruments Law are in force. True, that in 1938 a statute was passed (the constitutionality of which, we are informed, is not admitted by all) under which the creation of *some* trusts is authorized. Yet it lies in the author's mind that in Louisiana *private* law mainly stems from French law.

But the general statement may, we think, safely be made that in all the states, Louisiana alone excepted, at the *present* time the sources of the law are *usually* English sources. English law has flooded in and overlaid, for the most part, the underlying Spanish and French strata.

Blackstone became the American legal Bible, and remained so for decades. Abraham Lincoln, poring by candlelight over his Blackstone, will always be a beloved part of the American picture. *Thousands* of American judges and lawyers have derived their conceptions of choses in action and the unassignability thereof from Blackstone. We therefore give *verbatim* certain passages from his Commentaries. We have divided these into four parts, and, after the quotation of each part, we interject comment.

(1) "Having thus considered the several divisions of property in *possession,* which subsists there only, where a man hath both the right and also the occupation of the thing; we will proceed next to take a short view of the nature of property in *action,* or such where a man hath not the occupation, but merely a bare right to occupy the thing in question; the possession whereof may however be recovered by a suit or action at law; from whence the thing so recoverable is called a thing, or *chose, in action.*" Commentaries, Book II, pp. 396–397. (We have followed the eighth edition, published in 1778, as presumably the last edition which Blackstone approved.)

[Comment. At the opening there is the thought of the early Plantagenets (p. 42), the world of rights is divided into just two parts, — (1) possessory rights and (2) non-possessory rights. But, later, he says that a *non-possessory right* is one that may be *"recovered by a suit or action of law."* A disseisee's right would be an example. *But,* non-possessory rights which may not forthwith be recovered by an action at law (for example, a reversion) are not even mentioned. He divides the world of rights into the early Plantagenet first and second parts, but then he mentions only a fraction of such second part].

(2) "Thus money due on a bond is a *chose* in action; for a property in the debt vests at the time of forfeiture mentioned in the obligation, but there is no possession till recovered by course of law. If a man promises, or covenants with me, to do any act, and fails in it, whereby I suffer damage, the recompense for this damage is a *chose* in action; for though a right to some recompense

vests in me at the time of damage done, yet what and how large such recompense shall be, can only be ascertained by verdict; and the possession can only be given me by legal judgment and execution. In the former of these cases the student will observe, that the property, or right of action, depends upon an *express* contract or obligation to pay a stated sum: and in the latter it depends upon an *implied* contract, that if the covenantor does not perform the act he engaged to do, he shall pay me the damages I sustain by this breach of covenant. And hence it may be collected, that all property in action depends entirely upon contracts, either express or implied; which are the only regular means of acquiring a *chose* in action, and of the nature of which we shall discourse at large in a subsequent chapter." (p. 397)

[Comment. "*All property in action depends entirely upon contracts,* either express or implied; which are the *only* regular means of acquiring a chose in action." The property in the debt vests *at the time of forfeiture.* It is money *due* on a bond which is a "chose in action." If a man promises to do an act, and *fails* in it, whereby the promisee suffers damage, the *recompense* is a "chose in action."

[In this passage he is using "chose in action" with a meaning even *narrower* than Coke's *narrow* meaning (p. 53). It is confined to *causes of action,* but includes only *some* causes of action, — those which arose upon a breach of *contract.* It does not include a cause of action arising from the commission of a tort. And it does not even include the right of action in a disseisee! But we have already seen (p. 55) that the disseisee's right was the "chose in action" *par excellence.* We cannot believe that Blackstone had (at least shortly before he wrote this passage) carefully perused the pertinent parts of Coke's writings. If he had embarked upon a voyage of discovery to find out what Coke meant by "choses in action," he could no more have missed the disseisee's right than Cristoforo Colombo could have missed America].

(3) "A contract, which usually conveys an interest merely in action, is thus defined: 'an agreement upon sufficient consideration, to do or not to do a particular thing.' From which definition

there arise three points to be contemplated in all contracts; 1. The *agreement;* 2. The *consideration;* and 3. The *thing* to be done or omitted, or the different species of contracts.

"*First* then it is an *agreement,* a mutual bargain or convention; and therefore there must at least be two contracting parties, of sufficient ability to make a contract; as where A contracts with B to pay him £100 and thereby transfers a property in such sum to B. Which property is however not in possession, but in action merely, and recoverable by suit at law . . ." (p. 442)

[Comment. "Where A contracts with B to pay him £100 and thereby transfers a *property* in such *sum* to B." Note that here Blackstone is confusing the distinction between a debtor-creditor relationship and a bailor-bailee relationship (p. 116). His thought seems to be that *specific* money has been bailed and that *that* money is to be restored. This carries us back to the Plantagenet days when debt and detinue were blurred, when debt lay to recover a horse that had been bailed, and detinue lay to secure payment of money borrowed. His thought pretty surely was that, on a loan of money, the lender retained the *reversionary* interest in the *specific* money, and that this reversionary interest in specific money was a "chose in action." Here he is using the term in a *broad* meaning consistent with the early *οἱ πολλοί* Plantagenet meaning.]

(4) ". . . wherefore it could not be transferred to another person by the strict rules of the ancient common law; for no *chose* in action could be assigned or granted over, because it was thought to be a great encouragement to litigiousness, if a man were allowed to make over to a stranger his right of going to law. But this nicety is now disregarded: though, in compliance with the ancient principle, the form of assigning a *chose* in action is in the nature of a declaration of trust, and an agreement to permit the assignee to make use of the name of the assignor, in order to recover the possession. And therefore, when in common acceptation a debt or bond is said to be assigned over, it must still be sued in the original creditor's name; the person to whom it is transferred being rather an attorney than an assignee. But the King is an exception to this general rule, for he might always

either grant or receive a *chose* in action by assignment: and our courts of equity, considering that in a commercial country almost all personal property must necessarily lie in contract, will protect the assignment of a *chose* in action, as much as the law will that of a *chose* in possession." (p. 442)

[Comment. Here he switches back to Coke's *narrow* meaning (a " chose in action " is a cause of action), and gives as the reason, the *only* reason, why the debt for 100 pounds (passage No. 3) is unassignable is " because it was thought to be a great encouragement to make over to a stranger his right of going to law." But that reason is not applicable to a debt *before* default, which is only a " chose in action " in the *broad* meaning. That is the pith of his confusion.]

These passages are a hodgepodge. They are the product of a momentarily undiscriminating mind. He switches from a *broad* meaning (1), to a *narrow* meaning (2), then switches back to a *broad* meaning (3), and winds up by giving as the reason, the *only* reason, for the unassignability of a chose in action in the *broad* meaning a reason which has no application except to a chose in action in the *narrow* meaning (4).

Blackstone was very good at stating land law, — the law of descent, and so on, and some legal conceptions he expressed artistically. But Blackstone was not much interested in the law as it affected " trade." If he had been charged with being unfamiliar with the law relating to " trade," we rather think that he might have been delighted with his own delinquency, — might have thought it rather good form not to know about " trade." The descendants of sires who had been only " also rans " in Plantagenet days, were now winning a good deal of the prize money, but Blackstone still backed only the aristocratic land horses. That the people of the United States who were so keen on business should for decades have accepted as their major legal prophet a person who knew little, and cared less, about the laws of " trade " would have been cause for laughter by the Gods in a Homeric age.

Legend has it that he found life a pleasant thing, — that he loved to wander through the green pastures and by the still waters. We are unable to resist picturing him as at times in his easy chair,

duly appreciating a bottle of rare old port, and pleasantly bemusing as to how he should phrase it when he met the young gentlemen on the morrow.

Blackstone never saw clearly (or even dimly) the vital, fundamental difference between *creating* an enforceable promise to pay a sum of money, and *breaking* that promise. He was, on the matter of the assignability of contract rights, a source of darkness and misleading.

In conclusion, as to the objection to assignability based on "maintenance." It just does not apply to the assignability of a debt *before default*. It is only by the alchemy of high-voltage confusion that it can even be thought to apply.

Moreover. *Assume* that a debt, before default, is unassignable. B owns a debt, A being the debtor. B needs ready cash. He wants to sell the debt to C. He consults his lawyer. The lawyer sadly shakes his head and tells him that this is not permitted. But, he adds, with sleek, smug smile, there is a way to get around that. He knows how. He will draw up a paper by which B will appoint C as his attorney-in-fact to collect the debt by suit or otherwise, and at the same time will authorize C to keep the amount collected for his own benefit. That will be a "practical" assignment; it will amount to the same thing.

B asks if the lawyer feels sure that that will not also be thrown out. It looks to him like beating the Devil around the stump. But the lawyer comforts B with Olympic calm. He assures him that *that* will be quite all right.

And the lawyer is right. True, time was when courts denounced such powers as maintenance. But the validity of such powers has been recognized for centuries.

Now, if there *is* any good reason for holding that a debt, before default, is unassignable, then a court stultifies itself by turning the blind eye to such a barefaced evasion. The truth is that courts know perfectly well that there is nothing but a husk left of the "maintenance" objection, so far as that objection applies to debts *before default*.

Yet this "maintenance" objection was for centuries the stock

objection, the well-mouthed objection, the *only* objection *stated* by courts until well into the nineteenth century.

There have probably been saner men in Bedlam than those who would seriously contend that the " maintenance " objection is a good reason why a modern court should persist in refusing to confirm the understanding of business men as to the assignability at law of debts *before default*.

Objection No. 3. *Personal Relationship.*

A makes to B an enforceable promise to pay a sum of money to B. Does that create such a personal relationship between A and B that B may not, without A's consent, substitute C for himself as owner of the debt so created? There are those who think that it does. They think that the personality of B is, so to speak, built into the very structure of the debt, and that the plain terms of the promise require that the debt be paid to B, and *to nobody but B.* " You cannot make a promise to Richard Roe out of a promise to John Doe."

In *Grymes v. Blofield*,[28] A borrowed from B; X (for some reason which is not stated) paid B the amount of A's debt to B; thereafter, B nevertheless sued A on the debt; and A pleaded the fact that B had already received payment from X. It was held that this was not a good plea. And there were cases even in the nineteenth century in which the courts approved of such a doctrine.[29] If payment to B *from* anyone other than A is not a good payment, then a payment *to* anyone other than B is not a good payment.

This thought is comprehensible. Two is company, three is a crowd. A and B are to have a tête-à-tête; let no third person butt in. Let A and B lead lives of splendid isolation.

The thought is comprehensible, — easily comprehensible. But is it sensible on a *business* matter? We think not.

Enforceable promises should be classified. The performance of some promises *does* involve what would popularly be called personal, *intimate* relations. A promise to marry is the clearest

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28 Cro. Eliz. 541 (1594).

29 They are collected in Williston, Contracts, § 1857.

illustration of such a promise (but many other illustrations might be given). With respect to *such* promises we concede, and urge, that the personality of the promisee is so built into the very structure of the promise that assignability is out of the question. But there are many promises which do *not* involve what would popularly be called personal, intimate relations. A promise to pay a defined sum of money is the clearest illustration of such a promise.

If A makes to B an enforceable promise to pay a sum of money to B, it is true that B's personality is essential to the *creation* of the debt. Of course, there cannot be an enforceable promise without a promisee. B serves as the indispensable promisee. But now look at the situation *after* the debt has been created. Business men regard B as the *first owner* of the debt so created. A debt is to them just one species of property. Alienability is a normal incident of ownership. Indeed, there is a large body of law *denouncing* restraints on alienation.[30] Why, when the law came to debts, a species of property (as dear to the hearts of merchants in the City of London as land was dear to the hearts of the county nobility and gentry), why did it execute a *volte-face,* and solemnly shake its head, and say that *this* species of property was inalienable? Our belief is that the main reason that the law took that curious, inconsistent position was because Plantagenet conceptions were in the subconsciousness of the judges (pp. 46–47).

Everyone concedes that C may be substituted for B as the legal owner of a debt by operation of law. Thus, if A dies, the obligation does not die. C, the executor or administrator, succeeds to the ownership of the debt. Thus too, if B becomes bankrupt, C, the representative of B's creditors, succeeds under bankruptcy statutes to the ownership of the debt.

The contention is made, however, that the law should not permit B *by his voluntary* act to substitute C in his place as the legal owner of the debt. We concede, and urge, that in some cases there may be a public policy against assignability (for example, of a pension granted to an aged person to guard him from destitution). But, unless there is some public policy against assignment, we can

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[30] Gray, Restraints on Alienation.

see no reason why the assignment of a debt before default should not be permitted, and permitted at law.

If A promises B to marry B, of course B may not substitute C. It makes a great deal of difference to A whom he marries. But, if A promises B to pay a sum of money to B, ordinarily it makes no difference to A to whom he pays the money, provided only that the person to whom he pays can give him a valid discharge.

We concede that in *some* circumstances the substitution of C for B might affect A unfavorably. Two examples. (1) A may have borrowed from B because B was a kindly, timid man who would not be likely to press him severely upon default, and B may have substituted a hard-boiled C. The substitution *does* make a difference to A, but we think that this is not unfair to A. The law will not allow C to exact from A more than A ought to pay. His hope that he would not be required to pay what he owes is frustrated, but that frustration does not involve unfairness. (2) A buys goods from B on credit, hoping that this will prove to be simply the first item in an account between A and B, that B will reciprocate and buy from him on credit, and thereby give him a set-off. If B sells A's debt to C, A's hope of a set-off against B is frustrated. The substitution of C for B *does* make a difference to A, it does frustrate A's hope, but that frustration does not involve unfairness. B must also be considered. In accepting a promise to pay rather than hard cash it may well be that he planned to raise ready money by selling the promise *if* his business needs should require it.

"But what," cries someone, "becomes of the distinction between a negotiable note and a non-negotiable note? I thought the distinction was *very* important between a promise *to B,* and a promise *to the order of B.* If the promise is made to the order of B, A gives his consent in advance to the substitution of C for B, but, if the promise is made to B, A has not given his consent. Your thought bewilders me. It seems to erase the distinction between a negotiable promissory note and a non-negotiable promissory note."

And it *does* erase the distinction so far as *assignability* is concerned. Or, rather, it frankly recognizes that such erasure has

already occurred in substance; for no court hesitates for a moment to allow B to make C his attorney-in-fact to exercise against A, *without A's consent,* all the rights of ownership.

We *do* propose that the erasure which has already occurred in substance through "practical" assignments should be frankly recognized as an erasure. We do propose that that which may be done indirectly may be done directly and frankly.

But to say that this erases the distinction between negotiable and non-negotiable instruments is *very* wide of the mark. It makes a difference — a very great difference — to A whether he gives a note to B, or a note to the order of B.

Negotiability is assignability, *plus. Assignability* of a debt does not expose the debtor to hurt. But the *negotiability* of a debt does.

Two examples. (1) A gives a negotiable promissory note to B. B secured it by fraud. B sells to C, a bona fide purchaser. The defrauded A must pay C. (2) A gives a negotiable promissory note to B. He has a counterclaim against B. B sells to C, a bona fide purchaser. A cannot use against C the counterclaim against B.

This is a line between negotiable and non-negotiable instruments which should be kept bright, which no confused reasoning by confused jurists (on or off the bench) should be allowed to blur. If a negotiable instrument by A to B is assigned by B to C, a bona fide purchaser, A loses *all* defenses and counterclaims against B. But *if a non-negotiable instrument is assigned by B to C, a bona fide purchaser, all defenses and all counterclaims which A had against B at the moment when B assigned to C are available to A against C.* C has stepped into B's shoes. (And, indeed, if A has no notice of the assignment, A will be protected whenever he in good faith thereafter deals with B as owner of the debt, because B will still be to A the "apparent" owner of the debt. See pp. 96–97.)

We divert for a moment to speak of "patent" and "latent" equities. For centuries the law of evidence has distinguished between a "patent" ambiguity, and a "latent" ambiguity. A

patent ambiguity is one that appears on the face of the document which is being construed. A latent ambiguity is one that is revealed only when the court seeks to apply the apparently unambiguous words of the document to persons or objects. A "latent" ambiguity is illustrated by the "two Johns" cases upon which the elder Thayer threw such a flood of light.

Now, we have sought to find the source of the expressions "patent" and "latent" equities. In *Redfearn v. Ferrier,* Eldon said that "the question here was — not between a debtor of S. and his assignee, but between the assignee and one possessing a secret equity — he had looked very anxiously and carefully to see whether there were any cases where latent equities had prevailed against intimated assignations, and he had found none. . . . If latent equities were suffered to prevail against assignations, the effect would be that nothing could ever be assigned; for as long as their Scotch neighbours retained any part of their characteristic shrewdness, they would never take an assignment if they were aware that by means of latent equities such assignments might give them nothing." [31]

Kent (1763–1847; on the bench from 1798, Chancellor of the Court of Chancery, New York, 1814–23; professor at Columbia Law School 1793–98, and 1823–26) followed this in *Murray v. Lylburn:* "The assignee can always go to the debtor, and ascertain what claims he may have against the bond, or other chose in action which he is about purchasing from the obligee; but he may not be able, with the utmost diligence, to ascertain the latent equity of some third person against the obligee." A few lines later he used the expression "secret equity." [32]

Neither Eldon not Kent used the expression "patent equity." They did not *contrast* "latent equities" with any other equities. Professor Pomeroy, however, did contrast, speaking of "equities, latent or open." [33] Later, someone — we do not know who it was — started using "patent" equity instead of "open." Possibly, that person was influenced by the love of a jingle; possibly, he

[31] 1 Dow 50, 71, 72 (1813).

[32] 2 Johns. Ch. 441, 442 (1817).

[33] 1 Equity Jurisprudence, p. 1449.

was influenced by a supposed resemblance to patent and latent ambiguities in the law of evidence.

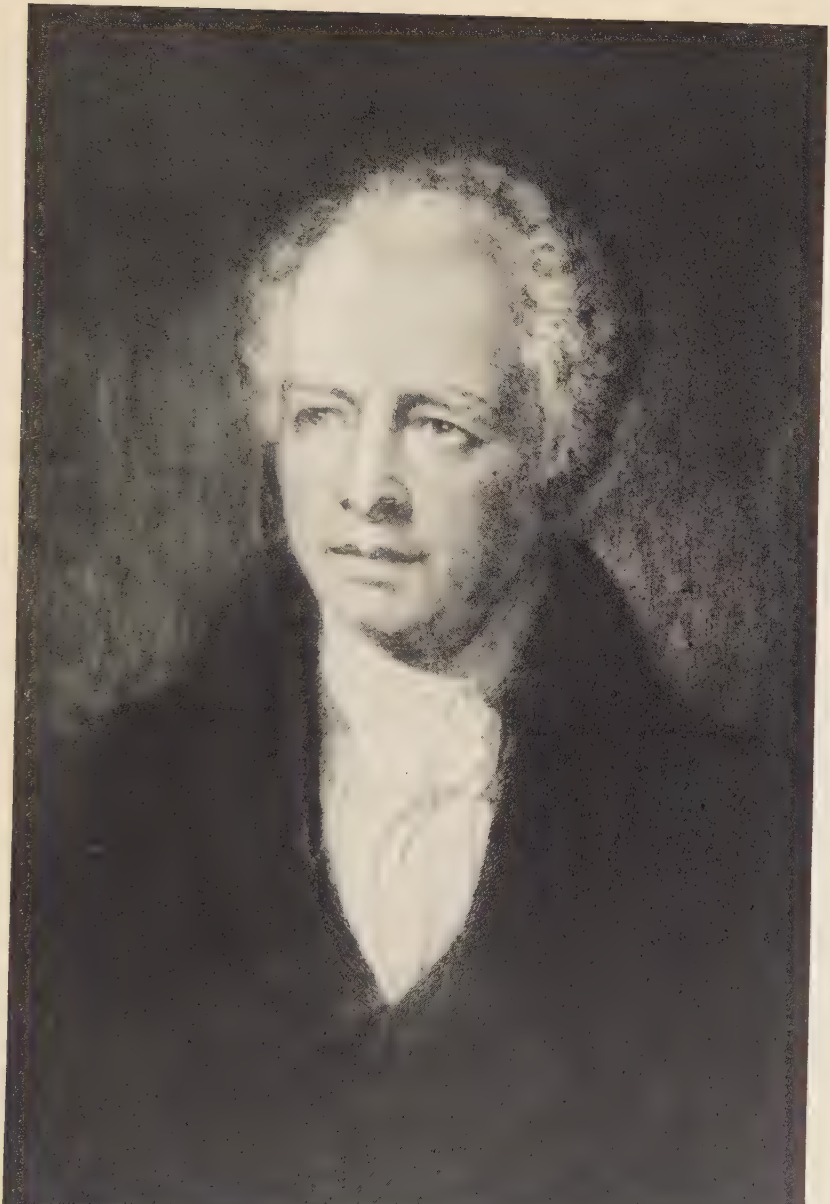
We think that the terms " patent " and " latent " equities are not helpful. They are explanatory terms which themselves require explanation. What do they mean? If B secured a note from A by fraud, some speak of A's defense as a patent equity. But what is there " patent " about it from the point of view of C? The only things that are " patent " to C are (1) that A *may* have have some defense against B and (2) that, if so, such defense will be good against himself, C. Now what does a " latent " equity mean? The passages quoted above from the opinions of Eldon and Kent show that what they meant by a latent equity was an equity in a *fourth party*. If A gives a note to B, and B assigns to C, there are three parties. (Necessarily, there are always three parties in any case involving the assignment of a debt.) Now, the rights of a fourth party *may* be involved. *That* is the latent element. Is there, or is there not, a fourth party in the picture? C can go to A and find out if A claims to have any defense or counterclaim and A will presumably tell him the facts as he knows them. But if C goes to B and asks him what he has previously done, and B has done something which gives some D the basis of a claim, B may lie to C. Suppose, for example, that B had already declared himself trustee of the debt for D and then is rascal enough to propose to sell the debt to C. In such case, D's equity would be a " latent " equity.

We recommend that the expressions " patent equities " and " latent equities " should *never* be used. Professor Scott speaks in his treatise of " equities of a third person against the obligee," and " equitable defenses of the obligor." [34] That is better, definitely better, than " patent equities " and " latent equities." Others contrast " affirmative equities " with " defensive equities."

But our *strong* preference is to contrast *" all defenses and all counterclaims, legal, equitable or statutory "* with *" fourth-party equities."* The reasons for that strong preference are as follows:

1. Neither the expression " equitable defenses of the obligor," nor the expression " defensive equities " covers the *whole* ground.

[34] Scott, Trusts, § 284, 1, p. 1578.



JAMES KENT

Chancellor of New York Court of Chancery
Professor of Law at Columbia

A counterclaim against B available under the common law doctrine of recoupment is also available to A against C; and a counterclaim against B available under some statute as a set-off is also available against C.

2. " Fourth-party equity " is an expression which at once connotes the problem. When A promises to pay B, and B assigns to C, the *first* question is about A. Ought A to pay anybody, and, if so, how much? Unless a *fourth* party has been brought in by B, that will be the *only* question. But B *may* bring in a fourth party; then a second question arises: To whom should A pay? *Is* there a fourth party with a claim?

3. It is essential, in order to lay firm, unshakeable foundations for a clear, simple, sensible, harmonious law of pledge, that it be established that, if A becomes a debtor to B, and the debt is not evidenced by a negotiable instrument but is secured by second-class security, and B, a rascal, sells the security to D, a bona fide purchaser, C wins over D, in spite of the fact that C came in *later* than D (the reason for preferring C being that C purchased the principal, primary thing while D purchased only the supporting, secondary thing). Now, if no C had come into the picture, we concede, and urge, that there should be a constructive trust in favor of D upon the legal title to the debt so long as B is the legal owner. But we urge that when C buys the debt he acquires the legal title to that debt *free* from the cumbering equity in favor of D.

More than one student, familiar with the expressions " affirmative equities " and " defensive equities " has said: " I do not think that the affirmative equity of D should be cut off so that C wins over D. I can see no reason for distinguishing between affirmative equities and defensive equities. If affirmative equities are cut off, then, logically, defensive equities should *also* be cut off and that would be plainly unfair to A. Therefore, I think that neither should be cut off."

We answer: " If B has a horse with spavins, and he declares himself trustee of that horse for the benefit of D, and then sells that horse to C, a bona fide purchaser, would C take the legal title free from the cumbering equity? " The student answers:

"Yes." "Would C acquire a horse without spavins?" The student answers: "Certainly not." Then we say: "The same principle applies here. *All kinds of defenses and counterclaims* which A has against B are *defects inherent in the thing purchased* — they are so to speak debt-spavins. And just as C takes the horse *cum onere* spavins, so C takes the debt *cum onere* defenses and counterclaims." The student sees that, and sees it quickly.

Professor Scott himself has never been confused about this. But there are persons (some of them not students) who have been, and are, confused. Perhaps the greatest advantage of stating the contrast in terms of (1) *defenses and counterclaims legal, equitable, or statutory,* and (2) *fourth-party equities* is that the very statement prevents such confusion, and is a real help in reaching correct solutions. When we have stated the problem in that way, we are already well on the way to the proper solution.

To return from this diversion as to "patent" and "latent" equities to the main stream of thought. We were dealing with the objection that, if a debt not evidenced by a negotiable instrument is treated by the law as assignable, this obliterates the difference between negotiable instruments and non-negotiable instruments. Nothing of the kind.

The most important differences between negotiable instruments and non-negotiable instruments are as follows:

(1) If the instrument is negotiable, a bona fide purchaser gets a clear title; if the instrument is non-negotiable, even a bona fide purchaser takes it subject to all defenses, and counterclaims, legal, equitable or statutory (debt-spavins).

(2) If the instrument is negotiable and in negotiable form, a bona fide purchaser from a finder or a thief gets a clear title; if the instrument is non-negotiable he does not.

(3) There is a presumption that consideration was given for a negotiable instrument; but no presumption that consideration was given for a non-negotiable instrument; and, as against a holder in due course of a negotiable instrument, lack of consideration is no defense.

Our doctrine leaves untouched these three very important dif-

ferences. We *do* contend that there is *not* a *fourth* difference, — to wit, that a debt if evidenced by a negotiable instrument *is* assignable, but that a debt not evidenced by a negotiable instrument is not even assignable.

Everyone concedes that a debt not evidenced by a negotiable instrument is "virtually" assignable. All that we seek is to erase that word "virtually."

Before we leave objection No. 3, it will be helpful to consider the attitude of courts of equity as to assignability. Surely, the vision of courts of equity as to what is fair is at least as good as the vision of courts of common law. As far back as 1641, we find the court speaking of this matter and saying that "if there were a consideration, such fact would make the assignment better in equity than at law." [35] There were decisions as early as 1707 [36] and 1733 [37] that assignments were good in equity.

We will close the discussion of objection No. 3 by quoting from an opinion by Mr. Justice Buller in 1791, in a case in the Court of King's Bench.[38] Note how this matter looked to a really strong common law judge even a century and a half ago. "It was in the last term suggested for consideration, whether this bill after the alteration were not a *chose in action,* which could not be assigned? It is laid down in our old books, that for avoiding maintenance a *chose in action* cannot be assigned, or granted over to another. *Co. Lit.* 214, *a,* 266, *a,* 2 *Roll.* 45, *l.* 40. The good sense of that rule seems to me to be very questionable; and in early as well as modern times it has been so explained away, that it remains at most only an objection to the form of the action in any case. In 2 *Roll. Abr.* 45 & 46, it is admitted that an obligation or other deed may be granted, so that the writing passes; but it is said that the grantee cannot sue for it *in his own name.* If a third person be permitted to acquire the interest in a thing, whether he is to bring the action in his own name, or in the name of the

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35 *Earl of Suffolk v. Greenvill,* 3 Reports in Chancery, 89.

36 *Crouch v. Martin,* 2 Vern. 595.

37 *Lord Carteret v. Paschal,* 3 P. Wms. 197.

38 *Master v. Miller,* 4 T. R. 320, at pp. 340–341.

grantor, does not seem to me to affect the question of maintenance. It is curious, and not altogether useless, to see how the doctrine of maintenance has from time to time been received in *Westminster Hall.* At one time, not only he who laid out money to assist another in his cause, but he that by his friendship or interest saved him an expense which he would otherwise be put to, was held guilty of maintenance. *Bro. Tit. Maintenance* 7.14.17. &c. Nay, if he officiously gave evidence, it was maintenance; so that he must have had a *subpoena,* or suppress the truth. That such doctrine repugnant to every honest feeling of the human heart should be soon laid aside must be expected. Accordingly a variety of exceptions were soon made; and, amongst others, it was held, that if a person has any interest in the thing in dispute, though on contingency only, he may lawfully maintain an action on it, 2 *Roll. Abr.* 115; but in the midst of all these doctrines on maintenance, there was one case in which the courts of law allowed of an assignment of a *chose in action,* and that was in the case of the Crown; for the courts did not feel themselves bold enough to tie up the property of the Crown, or to prevent that from being transferred. 3 *Leon.* 198, 2 *Cro.* 180. Courts of equity from the earliest times thought the doctrine too absurd for them to adopt; and therefore they always acted in direct contradiction to it; and we shall soon see that courts of law also altered their language on the subject very much. In 12 *Mod.* 554, the court speaks of an assignment of an apprentice, or an assignment of a bond, as things which are good between the parties; and to which they must give their sanction, and act upon. So an assignment of a *chose in action* has always been held a good consideration for a promise. It was so in 1 *Roll. Ab.* 29, *Sid.* 212. and *T. Jones,* 222.; and lastly, by all the Judges of *England,* in *Mouldsdale* against *Birchall,* 2 *Black.* 820, though the debt assigned was uncertain. After these cases, we may venture to say that the maxim was a bad one, and that it proceeded on a foundation which fails. But still it must be admitted, that though the courts of law have gone the length of taking notice of assignments of *choses in action* and of acting upon them, yet in many cases they have adhered to the formal objection, that the action shall be brought in the name of the assignor,

and not in the name of the assignee. *I see no use or convenience in preserving that shadow when the substance is gone; and that it is merely a shadow, is apparent from the later cases. . . .*" (Italics supplied.)

Objection No. 4. *Stare decisis*

Here is a rule, — reason or no reason, let it stand. It has been said that for centuries nobody thought of questioning the rule. We challenge that. The remarks of Mr. Justice Buller, just quoted, demonstrate that no such sweeping statement may properly be made. We concede that very frequently judges took the attitude that, reason or no reason, such was the law. There were judges in England who would no more have thought of questioning unassignability of debts at law (unless evidenced by negotiable instruments), than a Victorian rector would have thought of questioning the established doctrines of the Church of England. Such a judge might be unable to produce a reason for the rule but there was a halo of sanctity above the head of the rule. And many an American judge, getting the rule through the muddy conduit of Blackstone, also threw up his mental hands. Not his to reason why; his but to know and apply.

Not to waste vain regrets upon the past, is it not clear that at least the time has now come to put an end to this sort of thing? "Yes, yes," says someone, "but it is for the legislatures, not the courts, to deal the *coup de grace*." We challenge that. Such an attitude is a confession of judicial impotence.

Due respect should be paid to the precedents, and due respect is usually great respect. But *rigor mortis* sets in, if there is *never* to be recognition of the wisdom of departing from the precedents. "Conservatism" is of two kinds. There is such a thing as progressive conservatism, and there is such a thing as destructive conservatism. The good jurist, on or off the bench, is a blend of the conservative and the progressive. Just what is the proper blend is a question about which intelligent men have differed, and probably always will differ. The author inclines to have *a little* more conservatism than progressivism. He inclines to think that there is more danger in "experimenting" than most persons

realize. He thinks that the proper blend is achieved by combining about fifty-three per cent conservatism with about forty-seven per cent progressivism, but he can get along with anyone who has at least forty per cent of both.

It is as clear to him as the sun at noon on a cloudless day that for the courts to persist in stubbornly keeping legal conceptions as to the assignability of debts aloof from, and discordant with, the conceptions of business men is *destructive* conservatism, and will involve deterioration in the prestige of the courts, — in the confidence of laymen that the judges may be safely trusted to *develop* the law in accord with modern needs.

He conceives that it is a function of the judges — their highest function — *to develop the law in accord with modern needs.* Let there be no passing of the buck to the legislature. No adequate judge should hesitate to say that the law should be as follows: Unless there is some public policy to the contrary, *every* absolute obligation to pay a defined sum of money, with or without interest, at a specified date or on demand is assignable *at law,* and not merely in equity, *before default* (provided, nevertheless, that such assignment shall not be effective against the debtor until the debtor has received notice thereof).

Could a legislature, sympathetic with the thoughts of the author, do a better piece of work? Yes. Let the statute provide: Unless there is some public policy against it, *every* absolute obligation to pay a defined sum of money, with or without interest, at a specified date or on demand shall be assignable at law, and not merely in equity, *before default* (provided, nevertheless, that such assignment shall not be effective against the debtor until the debtor has received *written* notice thereof *from the assignee*).

Before the passage of the Statute of Frauds, the judges had a free hand to require *written* evidence of a fact. We will show in Appendix A an instance where medieval judges did require written evidence of a fact. But we believe that, on a sound construction of the usual Statute of Frauds, the intent of the legislature should be declared to be that written evidence of a fact shall be required in the cases, but *only* in the cases, specified in such statute. We do not believe that the legislature con-

templated *judicial supplements* to the statute. If such supplements are to be made, they should be made only by the legislature itself by supplementary statutes. And it would be a help (not, as a practical matter, very much help, but still a help) if the legislature provided that the debtor should not be affected by the assignment unless (1) notice thereof was in writing, and (2) such notice came from the assignee. This would cut out litigation as to whether the debtor had, or had not, in fact had notice from the assignee, or had notice from other sources sufficient to put him on inquiry.

Objection No. 5. *Williston*

(Samuel Williston, born 1861; member of the Harvard Law Faculty for forty-eight years; holder, in mediate succession from Story, of the Dane Professorship; a dynamic teacher with the suavity approach, — the mildest mannered man who ever tossed a student upon the horns of a dilemma; a wise counsellor, with substantial experience in guiding cases actually in court; draftsman of many uniform laws, including those on Sales, Warehouse Receipts, Bills of Lading, and Stock Certificates; reporter for the American Law Institute of its Restatement of the Law of Contracts; author of a monumental treatise on the Law of Contracts which is now recognized, and probably will for decades to come be recognized, as *the* American authority. We shall speak of him as " Williston "; the highest title is no title; the immortals have no title. The six persons mentioned in this book of whom it is natural for us to speak without giving a title are Coke, Mansfield, Eldon; Story, Kent, Williston. Williston will always be a beloved part of the Harvard Law School picture and a prominent part of the American Law picture).

Differences of opinion on the assignability at law of contract rights between Williston and the author have been much reduced by exchanges of thoughts. But substantial differences remain. The author regrets to say that Williston, while cordially conceding that the author's conclusion on the whole matter is well within the bounds of reason, nevertheless reaches himself the contrary conclusion. Williston believes that it is *wise,* considering the

needs of business men, to adhere to the traditional view that a debt, not evidenced by a negotiable instrument, is, even before default, assignable in equity but *not* at law (in the absence of a statute qualifying the legal title of the assignee to the same extent that equity has qualified his rights).

The differences may best be presented to the reader by use of the dialogue method of exposition. In the dialogue given below, at first the questions are by the author, and the answers by Williston. Toward the close, questioner and answerer change places, and the questions are by Williston, and the answers are by the author.

Q. Do you agree with me as to objection No. 1?

A. Yes. I think you acted wisely in giving so prominent a place to the possibility that Plantagenet conceptions in the subconsciousness may play a part in the reaching of conclusions. Your remarks on that seem to me to be justified. I also agree with you that there is a danger that persons who do historical research which has substantial value may too highly appraise the importance of what they have found as indicating what the law *ought* under *present* conditions to be.

Q. Do you agree with me as to objection No. 2?

A. Yes. You take a long time over Coke and Blackstone. If I had been doing it, I doubt if I should have taken so much time on that. But it may well be that you are right. There was certainly a mountain-heap of rubbish to remove. I am very glad to have someone make it look positively *silly* to suppose that "maintenance" is any reason for the unassignability of a debt before default. Some persons have irked me by apparently proceeding on the assumption that *that* was the reason for my views on unassignability. I am cordially and gratefully with you on objection No. 2.

Q. Do you agree with me as to objection No. 3?

A. Oh, that is a very different matter. I do not. I definitely disagree with you. Take the case of an enforceable promise by A to B to pay a sum of money to B. I believe that the sound construction of that promise is that it means just what it says, — that it is a promise to pay to B, and is not a promise to pay to B *or* to

someone else whom B may choose, without A's consent, to substitute in his place. I do think you make a promise to Richard Roe out of a promise to John Doe, and I challenge the propriety of that. I am surprised that you do not feel that difficulty more than you do.

Q. I have pondered long over that. Take those words: A makes to B an enforceable promise to pay a sum of money to B. In your thought, you underline the last two words: "to pay a sum of money *to B*." In my thought, I underline the first six words: "*to pay a sum of money* to B." I emphasize the nature of the benefit. Do you not emphasize the person who is to receive the benefit?

A. No. I do not underline the last two words. I underline nothing. One part is not given prominence at the expense of the other part. Indeed, I deny that there are two parts. "To pay a sum of money to B" is one, indivisible whole. I simply take the natural, unbiased construction.

Q. You use the adjective "unbiased." Is it in your mind that I have myself been guilty of allowing something in my subconsciousness to control my conclusion?

A. No. I concede, and believe, that you reached your conclusion by conscious reasoning processes, but I think that you approached the problem of construction with a disposition to adopt a construction under which assignability at law would be permitted, since you regarded that as vital (as one of the foundations of what you sincerely believe to be a better law concerning pledges). I did not intend to use "bias" in an offensive way, but, to my mind, anyone who approaches any question with a predisposition as to what answer he would like to find is influenced by bias. And using "bias" with that meaning, I do believe that in reaching your conclusion you were influenced by bias.

Q. I wince at the word "bias." But if the charge be that I approached this problem of construction with a predisposition to find a construction under which there would be assignability at law, I plead guilty. I admit that that is an accurate statement of my mental condition. I had the will to believe that such a construction was permissible.

A. I regard that as a very important admission, which goes to the root of the differences between us.

Q. I do not deny that I had that predisposition. I do not excuse it. I justify it.

When I came carefully to consider the matter, I was much impressed by two things: first, that business men take it for granted that all debts may be sold; and second, that the law was already permitting "virtual" assignments. I am very strong for the Mansfield approach, and am also very strong for the law's never allowing something to be done indirectly which it will not allow to be done directly. Therefore, to be consistent with myself I must incline toward the business men's point of view, and I must also support frank assignments if "virtual" assignments are already permitted. I believe that, once I had started independent thinking on this matter, I should have come out with the conclusion that I did reach. I believe that, but it is of course matter of conjecture. I must leave it at that. But you probably also think that I was overbold in adopting such a construction?

A. Possibly not overbold, but certainly bold. You yourself realize that you are taking a step which no Roman jurisconsult took, even in the days of a highly developed law, and the judges who have *consciously* taken it are certainly few.

Q. I fully recognize that. But the fact that my view is at present the minority view (so far as authorities go) has no more influence upon me than it would have upon you if the conditions were reversed. You adhere to the traditional view not because it is at present the majority view, but because you believe it is wise to adhere to it. Is that not your position?

A. In substance. But I should express it this way: I abide by the precedents, until I see some good reason to depart from them.

Q. And so do I. Is not the difference between us that I feel that there *is* a good reason for departing from the precedents, and that you do not think so?

A. Yes. But I make it stronger than that. I think that there is a good reason *for* adhering to the traditional view (in the absence of statute). When in due time you have finished putting questions to me, I should like to put a few questions to you.

Q. *Mais certainement.* But before we turn the spit, I want to ask even more questions.

A. I also know a few words of French. *Très bien.*

Q. Do you think that, as a practical matter, the doctrine that B may substitute C as the legal owner of the debt is unfair to A?

A. I answer " no," but only upon an important condition. In our first talk you said some surprising things. You sanctioned the idea that, where debt and security had been separated, the debt having been sold to C, a bona fide purchaser, and the security to D, another bona fide purchaser, and the debt was not evidenced by a negotiable instrument, the fact that the debt would be extinguished by A's payment to C was enough, *without more,* to justify a recovery by C against A, leaving A to chase after his property which had now been freed from incumbrance.

Q. That was terrible. The thought of that still brings a school-girl blush to my mental cheek. I lunged. You struck my rapier into the air. If you had been so minded, you could, right then and there, have given me the *coup de grace*.

A. I do not desire your death; you may live. And you quickly shifted to the position that C could recover against A if, but only if, C brought a proceeding in equity joining A and D, and the situation became such that as parts of one transaction (1) A must pay C, and (2) D must surrender the security to A.

Q. I have learned my lesson, and intend to be just as considerate of A as you are, — I now see clearly that A must be considered *first*. Are you content as to that point?

A. Yes. But do not have any throwback to your first thoughts.

Q. I promise always to balance § 174 by § 167. So help me. Do I meet adequately the criticism that my doctrine blurs the distinction between a negotiable instrument and a non-negotiable instrument?

A. Yes. Whether you draw the line in the proper place is debatable, but there is no blurring. You make it clear where you do draw it.

Q. So that as to objection No. 3, our differences are reduced to the proper construction of the promise?

A. Yes. Is B really the payee, or is he only the first owner?

On that question of construction I think that we must agree to disagree.

Q. Do you agree with me about objection No. 4?

A. Again, I cannot answer in a single word. I like what you say about the two brands of conservatism, — destructive and progressive. I like what you say about making legal conceptions accord with the understandings of business men. But, taking together the last part of your discussion of objection No. 3, and your discussion of objection No. 4, I think that you unintentionally may cause at least some readers to get a false impression as to the state of the authorities.

Q. It disturbs me to have you say that. What is the trouble?

A. You give too much prominence to what Mr. Justice Buller said. Remarks like his were so rare as to be almost curiosities. You do give a corrective in your Victorian rector, but, I think, not a sufficient corrective. The picture ought to have less Buller and more Victorian rector.

Q. (After a pause). I am sorry, but I cannot agree with you. I think the picture as drawn is accurate. Why should I not work up a dialogue between us, in which each of us states his opinion? That would at least serve as a warning to readers that perhaps Mr. Justice Buller's statements are out of focus.

A. If, on reflection, you are of opinion that that would be helpful, I shall raise no objection.

Q. So much for the four objections. Let me make one more attempt to see if we cannot agree on the pledge case which started me off on my independent thinking about the assignability of contract rights. There must have been moments when you regarded me as a bull in the contracts china shop.

A. I should not have myself given expression to any such thought. But, as you yourself have so expressed it, I will say that there have been moments. But, on the whole, you have been surprisingly gentle. Proceed with your pledge case.

Q. A gives a non-negotiable promissory note to B, and pledges jewels. B, a rascal, sells the jewels to D, a bona fide purchaser. On the facts, the doctrine of possession, *plus,* (p. 25) does not apply, and, therefore, D does *not* get what he thought he was getting. A court of equity will, to console D, impose a trust upon

B's legal title to the debt in favor of D. As a consequence, if no other person comes into the picture, D becomes the person entitled to receive from A payment of the debt. Do you think that this ought to be the law?

A. Yes.

Q. Now, suppose that B, the rascal, *after* he has sold the jewels to D assigns the debt to C, a bona fide purchaser. Under your doctrine, C's interest in the debt is not legal but only equitable. D's equity is first. C's equity is second. It seems to me that when debt and security are separated by a wrongdoer, and there are two bona fide purchasers, D of the security and C of the debt, then, since our law does not take the easy course of making a fifty-fifty split between the two good men, C and D, but seeks for a rational basis for preferring one to the other, the rational basis is to prefer the bona fide purchaser of the debt, because the debt is, as *all* courts agree, the principal, primary thing and the security is the supporting, secondary thing. Do you agree with me so far?

A. I am not prepared to answer that question in a single word. But let us proceed on the assumption that all you have said so far is true.

Q. Then does it not make *all* the difference whether the assignment to C is good at law or is only good in equity? If it is good at law, C, the man who ought to be protected, *is* protected. His protection follows as surely as day follows night under the familiar principle that the bona fide purchaser of a legal title takes it free from cumbering equities. But if the assignment is good only in equity, then C has only a second equity, and D — the wrong man to prevail — would prevail on the strength of his *prior* equity. Does not such result necessarily follow from your doctrine?

A. No.

Q. Why not?

A. The great chancellors have never said that a prior equity is hedged with finality. It is only when the scales are otherwise poised, that priority in time is the makeweight which tips the scales. An equity may be *superior, although subsequent*. In the case you have put, C's equity, although subsequent, might be held to be superior.

Q. Do you think it *should* be held to be superior?

A. I am not hostile to that idea. At the present moment I am not prepared to make a definite statement.

At this point, questioner and answerer changed places.

Q. Are not business men interested in the *results* reached by courts rather than in the roads travelled by the courts to reach those results?

A. Yes.

Q. If A, the debtor, B, the creditor, and C, the assignee from B, are the *only* persons concerned, are not business men satisfied with the results reached, if B is considered as the passive holder of the legal title, with an equitable duty not to interfere with C's exercise of the rights of ownership, and if C is considered as being entitled to exercise *all* the rights of ownership in B's name but for the benefit of C himself?

A. Yes.

Q. Now, suppose a *fourth* party is involved. You are interested in promises secured by pledge. But consider also promises which are unsecured. Is it not desirable that the law should be harmonious? Is it not wise to have one rule applicable both to secured promises and also to unsecured promises?

A. Yes.

Q. Now, consider a life insurance policy. Frequently, very frequently, partial assignments are made. If A issues a policy to B, and B makes a partial assignment to D, do you consider that D's interest in A's promise is legal or equitable?

A. I have no difficulty myself in thinking of it as a legal interest. My thinking is leading me to emphasize the similarities, rather than the dissimilarities, between a non-negotiable debt and an ordinary chattel. While there cannot be estates in chattels, there may be limited interests, — interests less than absolute ownership. I have no difficulty in visualizing limited *legal* interests in debts, and incline to think that the law is groping that way. But as yet the law is certainly not clear. Let us assume that D's interest is only equitable.

Q. Very well. Then if B, after making a partial assignment to

D, makes a total assignment to C, a bona fide purchaser, and C takes the legal title of the debt, as according to your doctrine he does, would C not take the legal title free from D's equity?

A. Yes.

Q. Is it not highly important, taking the business men's point of view, that the law should be so moulded that partial assignments should be protected?

A. Yes.

Q. Taking the business men's point of view — I agree heartily with you that that is the proper method of approach — is not your doctrine one that may have disastrous business consequences? Does not your doctrine expose every partial assignee to the risk of a destruction of his interest if B tortiously makes later a total assignment?

A. No.

Q. Why not?

A. My answer must be long. The first part of my thought is that since the law makes available to A against an assignee of the debt every defense and counterclaim which A had against B at the moment when B (according to my doctrine) substituted the assignee as the legal owner of the non-negotiable debt, no prudent man will buy such a debt without first speaking with the debtor to inquire if he has any defenses or counterclaims. Note that, in distinguishing between defenses and counterclaims on the one hand, and latent, or affirmative, or fourth-party equities on the other hand, Kent relied on the fact that the intending purchaser may consult the debtor before purchasing (p. 71). I think a rule of law which would regard the failure to make inquiry from A as inconsistent with the exercise of due prudence would be sensible, and in conformity with the thoughts of business men.

The second part of my thought is that, since the law protects A in any dealings he has with B, after B has assigned the debt, if A parts with value and has no notice of the assignment, every duly prudent man will, after purchasing a non-negotiable debt, forthwith give notice to the debtor. I think that this too is sensible and in conformity with the thoughts of business men.

The third part of my thought is that, in the light of the first

and second parts, any intending purchaser of the debt ought, on consulting A, to make more than an inquiry about defenses and counterclaims. There is a danger that there has been a previous assignment, total or partial. So that the purchaser's inquiry to A should not be limited to the inquiry: " Have you any defenses or counterclaims? " but should be the broad inquiry: " How about it? So far as you know, am I asking for trouble if I purchase this? " I think that to require the intending purchaser to make such broad inquiry is sensible and in conformity with the thoughts of business men.

If these three positions are sound, the rest is routine. The partial assignee must give notice to A. The intending total assignee is under a duty to make inquiry. If he fails to make inquiry, he will be charged with knowledge of all the facts which would have been unearthed by due inquiry. Therefore, the partial assignee prevails over the total assignee, *because the total assignee is not a bona fide purchaser.* " Bona fide " connotes not only the white soul, but also the gray brain.

Q. Does all that not in effect amount to the creation by the courts, on their own initiative, of a recording system for non-negotiable debts, similar to the recording system for land created by statute? Granting that such a recording system may be wise, ought that not to be left to the legislature?

A. No. I think it is the function of the courts to guide the *development* of the law, and that, so long as the courts establish rules in conformity with the thoughts of business men, the fact that those rules are also harmonious with what the legislature has thought wise with respect to another species of property is an argument for, not against, such rules.

Q. Are you not imposing upon the debtor certain duties, — making him in effect an unpaid recorder of assignments?

A. Yes.

Q. And did you not just a few moments ago, concede, and urge, that nothing should be done which is unfair to A, — that he must be considered first?

A. Yes.

Q. Is your present position consistent with that?

A. I think so. No doubt, I should prefer to put my answer in the form of saying that it is not inconsistent. I frankly say that that aspect of the matter gave me pause, and a long pause. But, after a long pause, I proceeded. Take your example of an insurance policy. I do not think that an insurance company would regard it as unreasonable that such a duty should be imposed upon it. I incline to think that insurance companies already regard the keeping of records of assignments as a normal incident in the conduct of the business. Moreover, they are interested in having clear, sensible rules laid down that will increase the usefulness of the policies in the hands of the persons insured. Moreover, the common law has long imposed similar duties upon bailees of chattels, and equity has long imposed similar duties upon trustees of both real and personal property.

We summarize. If A the debtor, B the creditor, and C the assignee, are the *only* persons involved (as they will be if B has not involved fourth parties) it does not make, except on one point, any difference in the result whether the doctrine of assignability at law or the doctrine of assignability only in equity is supported. The one point on which it makes a difference is as to the name of the plaintiff, if it becomes necessary to sue A. If the debt is assignable at law, C may sue in his own name. If it is not, he must sue in B's name. But this should be regarded as merely a procedural question, — and a relatively unimportant procedural question.

Now, no doubt such assignments do form well over ninety per cent of the assignments made. Cases where a fourth party has been involved are the exception, not the rule, and, unless a fourth party has been involved, there is no problem except when suit becomes necessary and some lawyer has brought suit in the name of C, although in that jurisdiction it should have been brought in the name of B.

But, when a fourth party has been involved, that is a very different matter. Almost all the cases which *get into court,* which the judges are called upon to decide one way or another, are cases where there *is* a fourth party. For the purpose of deciding litigated cases properly it becomes necessary to consider not simply

the *business results* attained in the run-of-the-mill assignments, but the *legal reasons* which support those business results.

Two cases were put above where fourth parties had become involved.

Williston emphasizes unsecured debts, and is particularly concerned to protect, say, the partial assignee of a life insurance policy. Williston and the author both want to protect the partial assignee. Under his doctrine he moves swiftly to the desired result. Under the author's doctrine, he also reaches the desired result, but more slowly.

The author emphasizes cases where the debt is second-class or third-class, the security is second-class, and debt and security have been separated, and the sale of the security to D came *before* the sale of the debt to C. His doctrine leads swiftly to the desired result while Williston's thought *permits* reaching that result (assuming that it ought to be reached) by a doctrine that an equity may, though subsequent, be superior.

We are not hostile to a doctrine that an equity, although subsequent, may be superior. But many a judge would breathe hard if he were asked to travel *that* road. It cannot, we think, be said to be a familiar, established doctrine. On the other hand, there are few, if any, doctrines more familiar, more firmly established, than the doctrine that the bona fide purchaser of a legal title takes that title free from cumbering equities. We are seeking to develop a clear, simple, sensible, harmonious law of pledge. The present law is a bog, — no milder word is adequate. How to drain that bog? We think that we see a way, but that way involves establishing, on a *firm, unshakeable* foundation, the doctrine that in any case where there is a non-negotiable debt and a second-class security, and B has separated the two, C, the bona fide purchaser of the debt, *always* prevails over D, the bona fide purchaser of the security, whether C bought before *or after* D bought, and whether the debt is evidenced by a negotiable instrument or not. Now, a court *might* reach that result on the ground of a superior, though subsequent, equity. *Sed quaere.* But, if it is established that C took the legal title, and not merely an equity, then there is not the slightest reason to worry about the result which

even a rather weak judge will reach. The judge will not be exploring unfamiliar territory, but will be travelling along a well-trodden, familiar road over which he has travelled again and again.

This brings us to Mansfield (1704–1793). He was a Scotsman who did very well for himself in England (as many another Scotsman has done). He was a great power in politics in the latter half of the eighteenth century. He was a warm advocate of an enlightened and considerate policy toward the American colonies. For over thirty years he was Chief Justice of the King's Bench, and, as such, Lord Chief Justice of England. More than once, he waved away the Lord Chancellor crown. Said the County Member: "What is greater than to be Lord Chancellor?" Said the City Member: "To decline to be Lord Chancellor and to be Lord Mansfield." Mansfield loved his work. He was never more in his element than when presiding at Nisi Prius in the Guildhall with a special jury of London merchants. He was learned, but he kept learning in its place, — it was his servant, not his master. He was clothed with Olympic serenity, as with a garment. He was dignified without being pompous, considerate without being condescending. He was a master of lucid, persuasive exposition. He seems to us to have been *just* the right blend of the conservative and progressive, — the perfect judge, without fear and without reproach, reliable, shrewd, wise.

No other judge, English or American, has had such an effect upon the author's legal thinking as has Mansfield. He is a disciple of Mansfield.

Now, in dealing with business questions, Mansfield always sought to learn what were the customs, usages and understandings of business men. And he inclined to confirm them. He did not *always* confirm them. There might be some reason in public policy which blocked confirmation. But he *inclined* to confirm. His thought was: Let business men generate their own law, so long as what they generate does not offend public policy.

He was not the first judge to have such an idea. Toward the close of the seventeenth century, Lord Holt had applied the idea with respect to foreign bills of exchange. Then for some reason

he went reactionary over promissory notes, payable to the order of the payee. He got into a dispute with the City over that. Legend has it that he exclaimed in a huff: "It is not for Lombard Street to give the law to Westminster Hall." But Parliament intervened and the merchants triumphed.[39]

Mansfield relighted the torch that Lord Holt had thrown down. He and his able puisne judges consolidated the gains already made by judicial decision or statute, removed anomalies, and developed the law of negotiable instruments. Everybody now says: "Well done. But of course. Why was it not done long before?"

The strongest argument for our conclusion on assignability of debts, before default, is that in reaching it we are following the Mansfield lead. First inquire what are the customs, usages and understandings of business men. Next inquire whether there is today any good reason why the law should not confirm. Whether there is any such good reason is, no doubt, a question which can only be answered by a wise exercise of judgment. We are convinced that there is none.

Therefore let the good work begun by Mansfield be extended. The law is moving that way, and with an increasing momentum. We believe that our views as to the assignability at law of debts before default (even if those debts are not evidenced by negotiable instruments) will ultimately prevail, and that then people will be saying: "Well done. But of course. Why was it not done long before?"

We have a growling ally with bulldog qualities. We put great reliance in his teeth and tenacity. We are confident that he will come out top-dog. That ally is the twentieth-century insistence that the law be made more simple, more easily understandable by intelligent laymen.

Two topics remain to be considered, — (1) statutes, and (2) the legal *power* theory.

1. *Statutes.* What importance is to be attached to the statutes under which C, the assignee of a non-negotiable debt, may sue A

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[39] 3, 4 ANNE, c. 9 (1704).

WILLIAM MURRAY, EARL OF MANSFIELD
Lord Chief Justice of England

in C's name? That depends. If the statute in terms authorizes an assignee to sue in his own name, it is merely procedural. But suppose the statute is general in its terms, authorizing and/or requiring legal proceedings to be brought in the name of "the real party in interest." The courts have unhesitatingly put the cap of "the real party in interest" upon the head of C, the assignee of a non-negotiable debt. This tends to make one feel more than ever that the court is distinguishing between tweedledee and tweedledum when it recognizes that C is the real party in interest, but refuses to recognize him as the owner at law. Note that the courts have not, usually at least, interpreted such a statute as permitting suits in the name of the beneficiary of a trust instead of in the name of the trustee.

2. *The legal "power" theory.* Several persons inclined to accept the title theory as the more "wholesome, common sense" theory, have hesitated to accept it because if B has assigned to C, and A has no notice of that fact, A is protected if he in good faith pays B. But reflection will show that this situation only arises where C neglects to notify A. The case is analogous to a case where a grantee of land neglects to record, or the purchaser of a chattel neglects to take the chattel out of the possession of the vendor. In all three cases, C gets a *defeasible* title. A defeasible title was one of the earliest conceptions of our law.

There may be some who will find the following dialogue helpful. The questions are put by the author; the answers are made by an esteemed junior colleague.

Q. Do you support the legal power doctrine rather than the legal title doctrine?

A. Yes.

Q. What is your conception of "title"?

A. We probably differ right at the start. You, I suspect, regard title as a mystical something. But I search to find what rights the law, in fact, does see fit to permit with respect to any particular species of property, and "title" is to me simply a convenient term connoting the totality of those rights.

Q. I wince at finding that you thought of me as thinking of

" title " as a mystical something. There is no basis whatever for that. I am well content with your definition of title.

Now, suppose that A goes into B's shop, and buys goods on credit. B makes an entry in his books, but there is no written evidence, *signed by A*. Do you have any difficulty in thinking of B as having the title to the debt?

A. None at all. Indeed, I should have the greatest difficulty in not thinking of B as having the title.

Q. In other words, your conception of title is not confined to land and chattels but extends to rights *in personam,* even those rights which are not evidenced by an instrument?

A. Yes.

Q. Are you at all troubled by the Plantagenet psychology that the quality of transferability was confined to those things which could be seen and touched?

A. Not at all.

Q. Are you at all troubled by the thought that the personality of B is built into the very structure of the debt, so that B cannot substitute C as owner?

A. Not at all.

Q. By the way, I speak of " having the title " and of " being the owner " as synonymous. Do you?

A. Yes.

Q. Now, A has created a book debt of which B has the title, — is the present owner. B becomes hard pressed for ready cash and sells the debt to C. At least, that is the way that business men would put it. C pays cash to B, and B assigns A's debt to C. Does B intend to transfer to C all his rights respecting that debt?

A. Yes.

Q. *All* of his rights? No exception whatever?

A. I agree that he *intends* to transfer all his rights. At least, I will assume that he is an honest man, and certainly he will intend, if honest, to transfer *all* his rights to C, and will make no mental reservations.

Q. Do you think that there is any public policy which blocks the court from giving effect to his intent?

A. No. The idea that it is against public policy because it breeds litigation is fantastic. I think that it is usually, as a financial matter, bad for the owner of a book debt to assign it. It will hurt his credit. But whether it is for his financial good or not, he must take the responsibility of deciding. I believe in rugged individualism at least to that extent. The law ought not to block it.

Q. Then I do not see why you do not agree with me in concluding that the legal title to the debt has passed from B to C. You say that B has the title, and that the reason why he has the title is because he has all the rights which the law permits with respect to that species of property. Then you further say that B intends to transfer all his rights respecting that debt to C, and that there is no public policy which blocks a court from giving effect to B's intent. Then, I submit, the court *should* give effect to B's intent. If it does, C now has all the rights which the law permits with respect to that species of property. If having all such rights gave B the title, why does not having all such rights also give C the title?

A. A transfer of ownership involves, as I think I have heard you yourself say, the substitution of one legal unit as owner in the place of another legal unit as owner. Now B may have *intended* to substitute C in his place, but he did not succeed in doing so.

Q. Why not?

A. Because, if, after B has sold to C, A without notice of the sale paid B, A would get a discharge good against C. That shows that B has not *succeeded* in substituting C for himself.

Q. Oh! That's the trouble, is it? If that is what is troubling you, I believe that we can quickly iron out the differences between us. I suggest that you think C is in B's place but has not displaced B, — that you are confusing " ownership " with " apparent ownership." I agree that B may remain " apparent " owner, if C does not notify A. But B's being the " apparent " owner is in nowise inconsistent with C's being the owner.

Suppose that A has the title to land. He delivers a deed of it to B. B does not record the deed. Where is the title to the land?

A. In B.

Q. The recording is not a condition precedent to the passing of the title?

A. No, at least under most statutes.

Q. Now A deeds the land to C, a bona fide purchaser. C gets the title. But that was not because A was the owner, but because A was the *apparent* owner. B's title was defeasible, but only through a wrongful act by A. Did not B have the title until A did that wrongful act?

A. Yes. But that is a statutory matter. There is no statute about book debts.

Q. Well, I do not think that that is a sufficient answer. But assume it is. I will put another case. A has a chattel, B buys and pays for it, but leaves it in A's possession. Where is the title?

A. In B.

Q. B's taking possession was not a condition precedent to the passing of the title?

A. No.

Q. Later A sells to C, a bona fide purchaser. C prevails, but that was not because A was the owner, but because A was the *apparent* owner. And there is no statute in that case. *That* case is on all fours with the case of the book debt. True it is, that if A pays B in good faith he will be protected. But that is not because A was the owner, but because A was the *apparent* owner. Is that not so?

A. (After a pause.) Yes.

Q. Moreover, think of this. The law *could* make the recording of a deed a condition precedent to passing the title — there are old statutes which did precisely that. Similarly, the law *could* make the taking of possession a condition precedent to the passing of the title to a chattel. So too, the law *could* make the giving of notice to the debtor a condition precedent to the passing of the title to a debt. Legislatures and judges usually think that that is not necessary; they let the titles pass, but expose a new owner to the risk of losing his title if he leaves the old owner in such a situation that the old owner is the apparent owner, and a third person, acting in good faith on the appearance of things, parts

with value. I suggest that you have been confusing a "legal power" to C with a "defeasible title" in C. Do not these thoughts remove from your mind your objection to my doctrine that C has acquired the legal title, — a *defeasible* legal title, but still a title, similar to a defeasible title in a piece of land or a chattel?

A. (After a pause, and with a smile.) You may call me Paul if you like. You have converted me.

We have discussed this matter with more than one junior colleague whose position was about as follows: (1) the personal relationship objection (objection No. 3, pp. 67–77) has weight with them, although not so much weight as it has with Williston; (2) they move unhesitatingly and swiftly to our result in the key case, — C, bona fide purchaser of a second-class or third-class debt, prevails over D, the *prior* bona fide purchaser of second-class security; (3) they reach that result by force of a doctrine that a bona fide purchaser of a *legal power* takes that power free from cumbering equities; and (4) they say that the choice between "legal power" and "legal title" is merely a nomenclature choice, and that the author makes too much ado about it. "A rose by some other name would not smell so sweet to *you*."

We are sorry that they do not understand us more perfectly. We are not making much ado about nomenclature. What we are making much ado about is the laying of *firm, unshakeable* foundations for a modern law of pledge which shall be clear, simple, sensible and harmonious in all its parts. We regard it as vital that C, the bona fide purchaser of the debt (the principal, primary thing), should *always* win over D, the bona fide purchaser of the second-class security (the supporting, secondary thing), whether the debt is first-class or second-class or third-class, and even if D's purchase was prior to C's purchase. We will be content with nothing less than that one hundred per cent of the judges shall be persuaded of the soundness of that result.

Now, it is true that that result *may* be reached by travelling any one of three different roads: (1) the legal title road; (2) the legal power road; (2) the superior, though subsequent, equity

road (p. 85). We do not believe that one hundred per cent of the judges, or anything like one hundred per cent, would feel at home on either the second or third road. But one hundred per cent will feel perfectly at home on the first road, — they have travelled that road time and time again.

Therefore, it is important that the spade be called a spade. There is something that looks like a spade, makes a noise like a spade, does the work of a spade. Stop this nice balancing between tweedledee and tweedledum. *Call it a spade.* And, at the same time, make legal conceptions and business conceptions harmonious.

We close this long, and rather strenuous, chapter, with a third dialogue. W is the author, X has the algebraic connotation. We trust that the susceptibilities of no one will be wounded by the satire in the closing part.

W. For years I "went along" with the traditional view that a promise to pay money, not evidenced by a negotiable instrument, is not assignable, — at least that it is not assignable at law. But now I question that. I do not see any valid reason why B, the legal owner of the right to receive a sum of money, should not be allowed to substitute C in his place as the *legal* owner of that right. Do you still adhere to the traditional view?

X. In a sense "Yes," but in a more important sense "No." You and I would probably reach the same results but by different processes of reasoning. A makes a promise to B to pay a sum of money to B. I don't see how you can require A to pay that money to C without forcing on him a contract which he never made. Has not that thought given you pause?

W. Yes. Of course, there cannot be an enforceable promise without a promisee, and therefore if A makes an enforceable promise to B, to pay a sum of money to B, B is indispensable to the creation of the contract right. But once the contract right has been created, I do not, after reflection, have any difficulty in thinking of B simply as owner of the contract right so created. Now, marketability is a usual and desirable incident of ownership. Business men desire to be able to market *all* debts owned by them,

if they have a business reason therefor. Therefore, I should like B to have the right to substitute C in his place as the legal owner of any contract right to receive payment of a sum of money, and I see nothing in the nature of a contract which blocks this.

X. I wish I could persuade myself to take, as easily as you do, the thought of eliminating the personality of B from the contract. I can't help feeling that B's personality is connected with the contract right, even *after* it is created. You concede that it was a promise to B to pay a sum of money *to B?*

W. Yes. But you underline *to B* in your thought, while I underline "*to pay a sum of money*" in my thought. I lay emphasis on the nature of the act to be done. I inquire whether it does, or does not, involve what would popularly be called a "personal" relationship. There is a difference in kind and not merely in degree between a promise to marry B where, of course, B's personality should never be eliminated, and a promise to pay a sum of money to B.

X. Perhaps that underlining does express the difference between us.

W. Would it be fair to say that you think of B and the contract right as Siamese twins?

X. I wince at the cartoon. But I cannot fairly object to it as a cartoon.

W. If B died, would the contract right die?

X. No. But that does not trouble me, for the executor or administrator is viewed as continuing B's personality.

W. If B went bankrupt, would you have any difficulty in allowing his trustee in bankruptcy to succeed to the ownership of the contract right?

X. No. But the trustee would take because the bankruptcy statute so directed.

W. You would not, however, denounce that statute as making a provision which ought not to have been made?

X. No. I have no difficulty about a succession in the ownership produced by operation of law. But I think the connection between the personality of B and the contract right ought not to be severed by the voluntary act of B.

W. You think that C may, by the voluntary act of B, be substituted for B as the person who has the right to receive the money from A, *only* if there is a novation?

X. Only if there is a novation. But where A makes a promise to pay to the *order* of B, he consents in advance to a novation.

W. Do you object to B's substituting C as the legal owner of a debt not evidenced by a negotiable instrument as being unfair to A?

X. Is the debt to be assignable, or negotiable?

W. Assignable only. I want C to be in no better position than that in which B was when he ceased to be owner; I want C to have derivative rights only.

X. Then I see no unfairness to A. The case is well within § 151 of the Restatement, Contracts, which seems sound to me.

W. When that section speaks of assignability, do you construe it to mean assignability in law or assignability in equity?

X. Assignability in law.

W. I have some difficulty in reconciling that construction of § 151 of the Restatement with § 447 of Williston's treatise on Contracts.

X. I do not think you should seek to reconcile them. In his treatise, Williston is giving us the benefit of his own convictions, opinions and conclusions. But the Restatement is a composite product. The restaters, as I understand it, sought to agree as to the *results*. They were concerned to state results reached, where they were in agreement as to results, without specifying whether these results were reached by travelling by the equitable road *or* by the legal road. I have reason to believe that Williston thought that the rights, and the limitations of the rights, of the assignee so stated were those established by courts of equity, with the sole exception made by § 174 where he, as Reporter, accepted the views of his advisers as to the road to be travelled. He accepted that, as worded, because he himself thought that the result might perhaps be the better result, from the practical point of view, even if it was not logically consistent with travelling by the equitable road.

There were, I have been informed, some differences of opinion,

and, if there was to be a Restatement, there had to be more or less give and take. Sole responsibility or credit for the Restatement should, therefore, not be placed upon, or given to, Williston. The treatise is Williston, pure and simple. But the Restatement is the product of a group. If the treatise and the Restatement are not altogether harmonious, that is not due to any confused thinking by Williston.

W. The Restatement is Williston, *plus?*

X. Or Williston, *minus,* as the case may be.

W. Do you use " assignable " and " transferable " as interchangeable terms?

X. (After a pause.) That is the most searching question you have asked. My impulse was to answer " Yes," but, after reflection, I answer " No." Transferability connotes to my mind the transfer of the legal title. Assignability does not connote that to my mind. I now think of it as a more comprehensive term than transferability. I should think it might well be used to cover both (a) cases where the legal title is transferred, and also (b) cases where through the giving of a legal power the same results are produced *as though* the legal title had been transferred.

W. But you do not think that a book debt is assignable in equity only?

X. No. Using assignable, as under the influence of your question I now define it, I have no difficulty in saying that the book debt is assignable at law.

W. Will you spell out for me your thoughts as to the assignability of contract rights for the payment of money, when not evidenced by negotiable instruments?

X. I think in terms of legal *power,* rather than legal *title.* I think that B can give C a power to collect the debt from A.

W. A legal power?

X. Yes.

W. Some have said that B gives C a beneficial agency. Do you distinguish between a power and a beneficial agency?

X. Definitely, yes. I regard a beneficial agency as a legal monstrosity. An agent is one who acts for another. A beneficial agency is a contradiction in terms.

W. So you would join me in throwing beneficial agency out of the window?

X. I would do more than that. I would open the window.

W. At least one of our colleagues thinks that B, after assignment to C, should be regarded as in the same position as he would be in if he had declared himself trustee of the debt for C. Does that appeal to you?

X. It once did. The idea has its attractions.

W. But not now for you?

X. No. It long ago receded into the background of my mind.

W. Have you thrown it out of the back window?

X. I haven't been quite as rough as that with it.

W. Any danger of your returning to an old love?

X. No.

W. Do you think that the two ideas of legal power and a quasi-declaration of trust are compatible?

X. No. I have talked with people who had one foot on the back of legal power and one foot on the back of quasi-declaration of trust. It is dangerous riding and I do not attempt the feat.

W. Do you under the doctrine of legal power always reach the same results as I reach under the doctrine of legal title?

X. Yes.

W. Always?

X. Yes. That is a searching question, but I have carefully thought it out.

W. You give the bona fide purchaser of a power just as great rights and just as full protection, even against persons who have acquired some equitable right in the debt, as you would give to a bona fide purchaser of the legal title?

X. Yes.

W. Take a pledge case which is worrying me. A incurs a debt to B. It is not evidenced by any document, but B required A to pledge certain articles with him before he would extend credit. Let us say that a ship chandler, B, requires the captain of a ship, A, to deposit security before he will supply the ship. B then sells the security to D, a bona fide purchaser. Would you agree that B became constructive trustee of the debt for the benefit of D?

X. Certainly.

W. Now, suppose that thereafter B makes to C, another bona fide purchaser, an assignment of the debt. Who is the person entitled to receive payment of that debt from A?

X. C.

W. Hurrah! That is for me the question, *par excellence,* and that is the answer I hoped for.

X. That is the result given by § 174 of the Restatement, which seems to me sound. But that should be read side by side with § 167, and due consideration should be given to *both* sections.

W. I am familiar with both sections and wholeheartedly agree. The question I put to you fairly presents the issue between legal assignability and equitable assignability. D acquired an equity in the debt. If C acquired only an equity, his equity would be a second equity and, therefore, presumably the inferior equity. But if C acquired the legal title then, as he is a bona fide purchaser, he would take that legal title free from fourth-party equities. Now I understand you to hold that a bona fide purchaser of a legal power takes that free from fourth-party equities.

X. I am not familiar with the expression " fourth-party equity."

W. In any case relating to the assignment of a debt there are necessarily three parties, — A, the debtor, B, the creditor, and C, the assignee. But a fourth party *may* be in the picture. In this case D is that fourth party.

X. I see. You use " fourth-party " equity where I speak of an " affirmative " equity. I now understand. You correctly state my position. My mind moves quickly to the conclusion that C takes free of D's equity.

W. Williston has a deep-rooted conviction that when A makes an enforceable promise to B to pay a sum of money to B, the personality of B is built into the very structure of the contract, and that this conception should be respected except in cases where courts of equity have held that adhering to this conception would cause fraud on a third party, and where it is also true that failure to adhere will cause no substantial injury to either of the original parties.

He thinks that courts of equity have held, and rightly held,

that, after the debtor has notice of the assignment, he should not be allowed to disregard every fact other than the personal relationship between debtor and creditor, and, therefore, that he should not be allowed to pay the original creditor, regardless of what is fair between that creditor and a third party who has come into the picture.

Unquestionably, his view is the traditional view in the common law, and it also receives sanction from the Roman law. Do you share his convictions?

X. Yes. At least I have those convictions. I really derived them from his teachings, and am unable to uproot them from my mind.

W. Williston has no difficulty in, say, ninety per cent of the cases with what, if " transferability " is used as a term connoting the passing of the legal title, may be called the substantive, or business, results of transferability?

X. None at all.

W. But he thinks that sometimes, say, in ten per cent of the cases, legal transferability produces an inequitable result, and he wants equity to be the master, using legal machinery only as a servant.

X. I do not think that you read his mind correctly.

W. You surprise me. How do you read his mind?

X. He goes deeper than that. Transferability results do not, even in ten per cent of the cases, disturb him as inequitable; they disturb him as being opposed to the best interests of the business community. He is fully as eager to meet the needs of business men as you and I are.

W. You say that transferability results do not, even in ten per cent of the cases, disturb him as inequitable. Will you spell that out for me?

X. If there is one rascal, and one bona fide purchaser, it is inequitable that the rascal should win. But if there is one rascal and two bona fide purchasers, that is another matter. If you have two bona fide purchasers, C and D, and the rascal has involved them, it is not inequitable that C should prevail over D, but equally it is not inequitable that D should prevail over C. There is noth-

ing which shocks the conscience in either result. It is just too bad that one of them has to lose, but in such cases that is inevitable.

W. Unless the court splits it, giving some part to C, and some part to D. I have read somewhere that a Scottish chieftain in like circumstances divides the articles or their proceeds between his two good followers, in proportion to the value from which each has been separated. But I probably read it not in a law book but in a romance.

X. It sounds more like Scott than Mansfield. But the idea has its attractions. It is not so dour. It would save a lot of time and litigation expense. To save is Scottish. However, as we do not live in the mild Scottish legal climate, we must abandon the fifty-fifty idea, and attempt to solve, as best we can, which good man is to get one hundred and which good man is to get zero.

W. Thank you for that. I now see clearly that, whether C or D wins, the result is not against good conscience, — is not an inequitable result. But I still do not see just what you meant when you said that some of the transferability results disturbed Williston as being opposed to the best interests of the business community. Will you give me a specific example?

X. Yes. Suppose A owes B. For value received, B makes a partial assignment of the debt to C.

W. And Williston thinks that C acquires only an equitable interest in the debt?

X. That is his conception, and I agree with him.

W. I have not thought that out.

X. Later, B, the rascal, for value received, makes a total assignment of the debt to D, who has no notice of C's rights.

W. Similar problems would arise with sums due on a contingency, as with insurance policies, I suppose?

X. Yes. It is a question of large practical importance. Williston conjectures that there are fully as many partial assignments as total assignments. He thinks the needs of the business community require that the partial assignee be protected. I agree with him.

W. Amen.

X. Now, if he adheres to the traditional common law view, the

partial assignee is protected, for D will take only an equity in the debt and will be subject to the prior equity in C. And so Williston protects C, not because it would be against conscience to protect D, but because the needs of the business community require that C be protected.

This doctrine that the assignment is good "in equity only" seems to me to be objectionable because it leaves the law in doubt in, say, ten per cent of the cases. If the restaters had been able to agree that as a general rule there should be legal assignability, but that this general rule should be subject to certain clearly defined exceptions, I should have gone along. But no such restatement has been made, and very likely it could not have been made without an abandonment, by some members of the composite unit, of principles which they felt that, in intellectual conscience, they could not abandon. But, the law not having been so clarified, I feel that the needs of the business community for reasonable certainty in the law require that in *all* cases there shall be legal assignability. At present, the law is in a shocking state of confusion.

W. Amen. As to the crying need of greater certainty in the law, and as to the mischievous consequences of leaving the law uncertain in, say, ten per cent of the cases, we see eye to eye. And I think that you would agree that not only is there need of greater certainty, but also of greater uniformity, and that this question of the assignability of rights to receive sums of money, when those rights are not evidenced by negotiable instruments, frequently arises in matters where many legal units are doing business in two or more states.

X. I agree heartily. On these matters there is not a bit of a shade of a shadow of a vestige of a trace of a scintilla of a possibility of a microscopic doubt of a complete agreement between us. These are questions of very great practical importance. That is why I am willing to go to the very verge of what seems to me to be permissible legal reasoning to attain the needed certainty and uniformity.

W. You think that I do more than to go to the verge, — that I go over the edge of the precipice?

X. Yes. I avert my eyes from what is to become of you. But I wish you a pleasant fall.

W. Let me tell you a gruesome tale. Once upon a time there was a prisoner in a grim, old fortress, built in Roman days, of contract conceptions. One black night he sought to escape by the rope of legal power. Down he came, hand under hand, to the end of his rope. His feet were swinging wildly. There were jagged rocks below. He clung and clung, but came the moment when he let go. You shudder?

X. I shudder.

W. He fell — one inch.

X. And therefore?

W. *Let go* the rope of legal power. You will come quickly, pleasantly, painlessly to earth. Your feet will be on the solid ground of legal title. At long last, your mind will be at peace, — the perfect peace of a clear understanding. No longer will your mental energies be drained by cautious, nice balancings.

X. You administer anaesthetics to your subject so that he shall not realize that you are intruding into his vitals.

W. I thank you.

X. Almost thou persuadest me to be a legal titleist. But no. I cannot, I must not. Get thee behind me. You are tempting me to fall. It is the old, old, centuries-old plea that it will only be such a *little* fall. No. God helping me, I shall not fall.

W. Then I must leave you in the air with below your feet a yawning one-inch chasm.

Chapter V

TROVER AND CONVERSION

THE law of pledge and the law of conversion are inextricably intertwined. Throughout the remainder of this book, nearly all the cases involve conversion.

This chapter is a foundation, preliminary chapter on conversion. It is divided into five parts:

I. A statement of the origin of the form of action known as trover; and a definition of that kind of tort known to the common law as a conversion.

II. An exposition of *Isaack v. Clark* (p. 119), the root-authority on tortious withholdings (one of the six species of conversion) by pledgees, and also of enough cases on tortious withholdings by persons *other* than pledgees to give an adequate background for the exposition in Chapter VI of the present law as to tortious withholdings by pledgees.

III. An exposition of enough cases on tortious transfers (another of the six species of conversion) by persons *other* than pledgees to give an adequate background for the exposition in Chapters VII to XI, both inclusive, of tortious transfers by pledgees.

IV. A discussion of " compensatory " and " involuntary-purchase " damages, as preliminary to the discussion of the rights of persons who purchase stocks on margin in Chapters VIII to X inclusive. Our contention is that a tortious repledge is both a conversion and a breach of contract, and that the pledgor should have a real, and not merely nominal, option to sue in tort or contract, and that, if he elects to sue in tort, the damages should be " involuntary-purchase " damages.

V. A discussion of remedies for the wrong of conversion, with particular reference to *Gordon v. Harper* (p. 152), and also to modern procedural statutes. This discussion is likewise preliminary to the discussion of margin customers cases in Chapters VIII to X inclusive. Our contention is that there is no more objection to the conception of a conversion by a pledgee of *the pledgor's*

interest, than there is to the conception of a conversion by a pledgor of *the pledgee's interest.*

I. *Some statements with respect to the origin of that form of action known as trover; and a definition of that kind of tort known to the common law as a conversion.*

At the dawn of the common law the judges gave most of their attention to unlawful *takings* of the possession of land or chattels.

Thus, a disseisin of land or chattels occurred only when B, the disseisor, without right took the land or chattel out of the actual or constructive possession of A into his own possession, claiming to be the owner of the fee of the land or of the chattel (as the case might be). There never was a disseisin without an ouster. Disseisin of chattels has, we think, faded out of the American picture, but in at least some American jurisdictions there may still be a disseisin of land (and it is very important *not* to confuse the doctrine of disseisin with the modern doctrine of adverse possession).[1] In such jurisdictions, it is still law that there is never a disseisin without an ouster, — a tortious *taking.*

Thus too, the common law crime of larceny at first involved a *taking* of a chattel out of the actual or constructive possession of the prosecutor into the possession of the prisoner, with an *animus furandi* existing at the moment of the taking. Later, the scope of this common law crime was enlarged by the judges,[2] and today larceny is often a statutory rather than a common law crime. But wherever larceny is still a common law crime, it is even today *the general rule* that there is no larceny unless there is a felonious taking.

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1 See 88 U. of P. Law Review, 897, 903–905.

2 Professor Livingston Hall is of opinion that the first departure from the original definition of larceny was in a so-called "breaking of bulk" case, decided in 1473 (see Jerome Hall, Theft, Law and Society, 315–346); that the rule that a finder of property was not guilty of larceny (stated in 1630 by Coke, Third Institute 107) was not changed even where the property was left, as in the "hackney coach" cases, until 1694 (see *Rex v. Lamb,* 2 East, P. C. 664); and that it was not until 1804 that a finder of lost property who, at the time he found the property, had reason to believe that he could locate the owner but determined to steal it was held guilty of larceny (see the anonymous case reported in 2 Russell, Crimes and Misdemeanors, 1044 (1st ed. 1819).

Thus too, the action of trespass *de bonis asportatis,* one of the oldest actions, could, as a general rule, be maintained only when the defendant took the chattel out of the actual or constructive possession of the plaintiff. There are more exceptions to that general rule than most persons realize (see p. 157 for four exceptions). But it is law today in all jurisdictions where the form of action known as trespass is still used that, as *a general rule,* the action only lies when the defendant took the chattel out of the actual or constructive possession of the plaintiff. Indeed, it is noteworthy that some modern judges have evidenced a stronger disinclination to any exception to this rule than did the Plantagenet judges (1154–1485) themselves.

Now, suppose A lost a chattel, and B found it and appropriated it to his own use. To allow A to maintain trespass against B would require a departure from the general rule. There are some old authorities, obscure and debatable, which tend to show that at least some judges were in favor of making such an exception to meet the case, if the defendant formed the intent to appropriate as soon as he took possession (note how this thought was later taken by the judges with respect to larceny, note 2 on p. 109), or if he destroyed it, or even if he refused to surrender on demand. But the received opinion came to be that trespass was not an appropriate remedy in such a case, and a *new* form of action was sanctioned to meet the case.

In this new form of action, the plaintiff alleged (1) that he was possessed of a certain chattel; (2) that he lost it; (3) that the defendant found it; (4) that the defendant took it into his possession; and (5) that the defendant converted it to his own use. Norman French was the usual language in law courts; " trouver " was " to find "; and hence this form of action came to be called, and ever since has been called, an action of trover.

Trover was an action on the case. In *Isaack v. Clark,*[3] decided in 1614, the court spoke of it as an " Action upon the case for a Trover and Conversion." Later, the courts sanctioned other forms of action which were called simply " actions on the case," without

[3] 2 Buls. 306.

any distinguishing name, and trover and simple case were *contrasted.*

Beginning in the middle of the nineteenth century numerous legislatures passed statutes designed to simplify remedies (see pp. 160–161). For several centuries prior to, say, 1850 the common law had given six remedies relating to wrongs respecting personal property, and nice distinctions had been taken between them. Of these six remedies, one — replevin — was a remedy whereby the plaintiff obtained the possession of a chattel; the plaintiff went after a thing, a *res,* and got it. But the other five — trespass *d.b.a.,* detinue,[4] trover, assumpsit and case — were remedies

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[4] Detinue antedated trover and ranked in antiquity with trespass *d.b.a.* If the plaintiff won, the judgment provided for the payment of a sum of money, but the defendant could mitigate the damages by delivery of the chattel in question. (Contrast the law in trover; see Appendix B.) In England, under Section 78 of the Common Law Procedure Act, 1854, if the successful plaintiff in detinue wanted the thing rather than money, the court might, in its discretion, *require* the defendant to surrender it rather than to pay its value. By force of this statute detinue became another remedy whereby a plaintiff could obtain the possession of a chattel. And this was important because detinue lay in cases where replevin did not lie.

It is interesting to note that the courts of equity also furnished a remedy for obtaining the possession of a chattel, *if* the chattel were of such a nature that money damages were not adequate compensation. See the case of *Elwes v. Brigg Gas Company,* L. R. 33 Chan. Div. 562, in which an equity court held that a landlord might get from a tenant a prehistoric boat, presumably two thousand years old, which the tenant had discovered while excavating.

But, at *common law,* replevin was the effective remedy for getting the possession of a chattel to which the plaintiff was entitled.

Before leaving detinue, it is important to note that it was sometimes used as a remedy for a tort, and sometimes as a remedy for a breach of contract. In early times it was *the* remedy for tortious withholdings (see the discussion of *Isaack v. Clark* at pp. 119, 120 for an account of the invasion by trover into this domain which had originally belonged exclusively to detinue). But detinue was also, in *bailment* cases, a remedy for a breach of the bailee's contract to return the chattel in accordance with the terms of the bailment. When detinue was used as a remedy for a breach of contract, the *ability* of the defendant to deliver, as he had promised to do, had nothing to do with the case (*cf.* pp. 120–122). Thus, in *Wilkinson v. Verity,* L. R. 6 C. P. 206, A bailed silver to B, the bailment being at will. B tortiously sold and delivered the silver to C. After more than six years (the pertinent period in the Statute of Limitations) A demanded the silver and, upon B's failure to produce, successfully maintained detinue as a remedy for B's breach of contract. We speak again of this case in the discussion of the *Dimock* case, p. 200, and again in the discussion of *Wood v. Fisk* at p. 254.

whereby the plaintiff went after a *person,* and got a judgment for a sum of money against that person.

The distinguishing allegation in an action of trover was that the defendant had converted the property to his own use.[5] Therefore the damages were for the *full value* of what had been converted. Grasp the full significance of that. It was in that rule as to the measure of damages that conversion lived, and moved, and had its chief significance. Abolish that measure of damages and conversion is abolished. The distinction between " compensatory damages " and " involuntary-purchase " damages goes to the root of the matter. We repeat that to abolish " involuntary-purchase " damages is to abolish conversion. Let him who hath not eyes to see that, forever hold his peace.

The damages obtained in the other four actions — trespass *d.b.a.,* detinue, assumpsit and simple case — *varied* according to the facts in the particular case, — the damages might be for the full value but they might be *trifling.* Plaintiffs who were after money rather than the thing therefore preferred trover, and that explains why for centuries cases in trover were more numerous than cases in trespass *d.b.a.* and detinue. Today, if an act is both a conversion and a breach of contract, there are those who push assumpsit to the fore and exclaim: " *Ecce, jus!* Behold the perfect remedy." Of the merits of this apotheosis of assumpsit, much more hereafter (pp. 139–147).

We pass to the second part of I, — the definition of that kind of tort known to the common law as a conversion.

We doubt if it is possible to make a terse definition which will prove reliable. Several terse definitions have been suggested, but we submit that they are either not broad enough or too broad.

For example, the late Dean Thayer inclined to stress the necessity for an " unauthorized assertion of dominion." We agree that in *most* species of conversion there is an unauthorized dominion by the defendant. But, " dominion " seems to us to connote a claim of ownership, or at least an exercise of some right incident to ownership.

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[5] *Isaack v. Clark,* 2 Buls. 308, 313 (1614).

Now, an important part — a *very* important part — of the law of conversion relates to unauthorized acts done by banks and trust companies in financial transactions where they have, although acting in good faith and with due care, treated some third person as the owner of some check, bill of exchange, promissory note, bond, or certificate for shares of stock (and so forth) which belonged to the plaintiff. They have denied plaintiff's title, *not* by claiming title for themselves, but simply by recognizing some *third person* as the owner. We question the propriety of speaking of such acts as exercises of dominion by the defendant. For this reason we do not adopt the " unauthorized assertion of dominion " formula.

We will give one example of an act which was a conversion but in which there was no exercise of dominion. In *Kleinwort, Sons & Co. v. Comptoir National D'Escompte de Paris* [6] a check was made payable to A. B, a rascal, obtained possession, obliterated the indorsement to A, substituted an indorsement to himself, presented it to C, the defendant bank in Paris, and requested the bank to forward it for collection to London. The defendant did so, and, on receiving a telegram from its London agents that the draft was honored, it paid the amount to B. A sued C, and was allowed to recover. Possibly, it is not confusing to speak of C as having exercised dominion in such a case, but we think it is not a helpful way in which to describe the wrong.

Others have said that *any* unauthorized dealing with a chattel, *any* tortious intermeddling, was a conversion. That seems to us too broad. For example. In *Fouldes v. Willoughby*,[7] the defendant operated a ferry from Birkenhead to Liverpool. The plaintiff had embarked on board the defendant's ferryboat at Birkenhead, having with him two horses, for the carriage of which he had paid the usual fare. It was alleged that the plaintiff misconducted himself after he came on board, and the defendant told the plaintiff that he would not carry the horses over, and that he must take them on shore. The plaintiff refused to do so, and the defendant took the horses from the plaintiff, who was holding one

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6 [1894] 2 Q. B. 157, 63 L. J., Q. B. 674, 10 R. 259.

7 8 M. & W. 540, 1 Dowl. (N.S.) 86, 10 L. J., Ex. 364, 5 Jur. 534 (1841).

of them by the bridle, and put them on shore on the landing slip. The plaintiff brought trover, and the defense set up at the trial was that the plaintiff had misconducted himself, and that the horses were sent on shore as a decoy in order to get rid of the plaintiff by inducing him to follow them. The judge told the jury that the defendant, *by taking the horses from the plaintiff and turning them out of the vessel,* had been guilty of a conversion, unless they thought that the plaintiff's conduct had justified his removal from the boat, and he had refused to go without his horses; and that, if they thought the conversion was proved, they might give the plaintiff damages for the full value of the horses. The jury gave a verdict for the plaintiff with £40 damages, the full value of the horses.

This case has frequently been misunderstood. The horses were later found in a stable and there was a refusal to give them up without a payment of money, and there was some basis for connecting the defendant with that tortious withholding. But the question was not whether on *all* the facts, the jury might have found that there was a conversion. The *sole* question was whether the judge's charge was correct. He had charged the jury that the *mere fact* of taking the horses from the plaintiff and turning them out of the vessel, was, *without more,* a conversion, — he had told them in effect that they might put out of consideration all later acts.

The court held that this single act of removal of a chattel, independent of any claim over it (either in favor of the defendant himself or of anyone else), did not amount to a conversion. Note that the possession of the defendant was for a very short period of time; that no damage whatever was done to the horses by the single act of taking them out of the boat and placing them on the landing slip; and that the defendant had not denied the plaintiff's title, but, on the contrary, had taken the horses only *because* they were the plaintiff's and in order to induce the plaintiff, being the owner, to follow them. The propriety of the decision has been questioned, but we think that it is law, and that it ought to be law.

We have no alternative *terse* definition of "conversion." Our definition of conversion is a very long one, — a regrettably long

one. But we can make no shorter definition which seems to us to be reliable and helpful. Our definition is as follows:

1. A conversion is a tort to some kinds of *personal* property. The common law knows no such thing as a conversion of real estate. Terms for years and at will in land are, for historical reasons, classified as personal property, but it is plain that they are not within the scope of conversion. There is no conversion of land. Originally, the scope did not extend beyond chattels. Today, it is plain that the scope is much broader than that. It extends to such muniments of title as bills of lading and warehouse receipts; and the damages for conversion thereof are *not* limited to the value of the chattel evidences of rights in the chattels, but include the value of the chattels themselves. Moreover — and this is even more important — it is plain that today the scope of conversion includes bonds and other documents containing a promise to pay money or an acknowledgment that money is due, even if such documents are not negotiable instruments (see the cases at pp. 204 and 207), and also certificates for shares of stock in corporations or in unincorporated business units which are not legal units; and that the damages for conversion thereof are not limited to the value of the chattel evidences of these rights *in personam,* but include the value of the rights *in personam.*

We have heard it said that money, unless it is money in a bag, is outside the scope of conversion. We do not so understand the law.

The origin of this misapprehension is interesting. At the dawn of the law, there was no bright line between debt and detinue. Debt might lie to recover a chattel improperly detained, and, conversely, detinue might lie to obtain payment of money loaned. Blackstone confused the bailor-bailee relationship with the creditor-debtor relationship (p. 64), and this mud seeped through to after-born lawyers. On a historic occasion, President Coolidge said: "They hired the money, didn't they?"

What caused him to choose to use this form of expression? There are persons who have a much livelier sense of their duty to return a borrowed *res* (like the lawn mower) than to pay another dollar in place of a borrowed dollar that has gone with the wind;

and President Coolidge *may* have deliberately chosen to express himself in a way to connote that those who had borrowed money still had the specific things borrowed. The more probable explanation is, however, that he had been a lawyer, that he had been accustomed to rely upon Blackstone, and that this form of expression was a throwback *via* Blackstone to the Plantagenets.

Modern judges drew a line between debt and detinue, and it came to be recognized that neither *detinue* nor *trover* was an appropriate method to secure payment of money due to be paid. But if *specific* money were tortiously withheld, that was different. Trover lay. This was established nearly two centuries ago by the decision in *Miller v. Race*.[8] That was trover for a bank note. The opinion was by Mansfield (p. 91), and the court was unanimous that trover lay, — that a bank note could be converted. Mansfield took it in his stride that a bank note was within the scope of conversion.

Just how large the scope of conversion will ultimately prove to be is matter of conjecture. It is sufficient for the purposes of this book to say that it at least extends to (a) chattels; (b) bills of lading, warehouse receipts, dock warrants and similar documents; (c) documentary promises to pay money or acknowledgments of the duty to pay money; and (d) shares of stock in incorporated or unincorporated business units evidenced by certificates.

2. A conversion is a tort by a defendant who by some means, lawful or unlawful, acquired *possession* of such property. We have seen (p. 110) that the action of trover was first sanctioned in order to give an appropriate remedy where A lost a chattel and B found it and took it into his possession and converted it. Very quickly the allegations about loss and finding were treated as non-traversable. The scope of the action was *greatly* enlarged, — it could be used not only against persons who had come into possession by finding, but also against any person who had come into possession in *any* manner. In a word, it could be used not only against finder-converters, but against *all* converters. But the action was still called an action of trover. It was like a

[8] 1 Burr. 452 (1758).

tool originally designed for a single purpose and given a name indicating that purpose, which, although it later came to be used for a number of other purposes, yet still was called by the old name. *But*, although the necessity of proving that the defendant came into possession " by finding " passed away, it continued to be, and is today, necessary for the plaintiff to allege and prove that the defendant came into possession *in some manner*.

It is, however, important to note that the courts are agreed that where chattels are bailed, and the bailee has issued some document such as a bill of lading, or warehouse receipt, or dock warrant, a defendant who as holder of such document would be recognized by the bailee as entitled to the possession (upon payment of the bailee's charges) has come so close to acquiring possession of the chattels that he cannot escape liability as a converter on the ground that he never came into possession of the goods. He has acquired " virtual " possession, and " virtual " possession is enough.[9]

For a further discussion of this requirement, see Appendix C.

3. A conversion is a tort which is a *misfeasance* as distinguished from a nonfeasance. We consider this at length at pp. 118–123.

4. A conversion is a *major* tort as distinguished from a minor tort. The case of *Fouldes v. Willoughby* which we have just given at p. 113 is one illustration of a minor tort. But of this distinction, more hereafter.

We, therefore, define a conversion as a tort (1) to some kinds of personal property, (2) by a defendant who by some means, lawful or unlawful, acquired possession, which tort amounted (3) to a misfeasance as distinguished from a nonfeasance, and (4) to a major tort as distinguished from a minor tort.

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[9] See *M'Combie v. Davies*, 6 East 538, 7 East 5, 2 Smith 557, 8 R. R. 534 (1805); *Mallalieu v. Laugher*, 3 Carr. & P. 551, 553 (N. P. 1828); *Johnson v. Stear*, 15 C. B. (N.S.) 330, 337. 33 L. J., C. P. 130, 10 Jur. (N.S.) 99, 9 L. T. (N.S.) 538, 12 W. R. 347 (1863); *Traylor v. Horrall*, 4 Blackf. (Ind.) 317, 319 (1837).

In *M'Combie v. Davies*, the tobacco was in the King's warehouse subject to the payment of duties and it does not affirmatively appear that there was any evidence of the owner's right other than an entry on the books of the warehouse. We doubt if Government usually issued formal warehouse receipts.

We have found it helpful to distinguish between six species of conversions as follows: (1) tortious *takings* of the possession by force or fraud; (2) tortious *withholdings* of the possession; (3) tortious *transfers* of the possession; (4) tortious alterations of the condition of the property; (5) tortious users of the property; and (6) denials of the plaintiff's rights in the property *either* (a) by a claim of title made by the defendant in his own behalf, or (b) by recognizing some third person as having rights therein which are inconsistent with plaintiff's rights. The cases on conversion are legion, but we believe that every case in which any court has held that there was a conversion falls under some one or more of these six heads.

Now, although the law of pledge is inextricably intertwined with the law of conversion, not all of those six species of conversion are pertinent. Almost all conversions by pledgees are either tortious withholdings (2), or tortious transfers (3), and/or denials of the plaintiff's rights by assuming to be owner (6a). Not infrequently there is a double-headed conversion, — as where a rascal pledgee assumes to be the owner of the pledge (6a) and sells and delivers it to some purchaser (3).

As species (1) *cannot* apply in pledge cases (since there is no pledge unless the alleged pledgee *lawfully* acquired the possession), and as species (4), (5) and (6b) rarely apply in pledge cases, we have put in Appendix D enough to give any reader who desires it some notion of the law as to conversions by persons *other* than pledgees in (1), (4) and (5). And we have already given in the text in the *Kleinwort* case (p. 113) one illustration of a (6b) species of conversion.

To summarize: We shall in the subsequent chapters deal with conversions by pledgees through tortious withholdings (Chapter VI), and tortious transfers (Chapters VII to XI). Sometimes, the tortious withholding or transfer is accompanied by a claim of title by the converter, and therefore becomes a double-headed conversion.

II. *An exposition of* Isaack v. Clark, *the root-authority on tortious withholdings* (*one of the six species of conversion*) *by*

pledgees, and also of enough cases on tortious withholdings by persons other *than pledgees to give an adequate background for the exposition in Chapter VI of the present law as to tortious withholdings by pledgees.*

Isaack v. Clark.[10] The report is stiff reading; there are obviously cross currents of thought. We do not feel confident that, even after much study, we have fathomed what the reporter wished to say, but we believe that the following statements are reliable:

(1) The facts and issue. A pledged to B a bag of money, to be redelivered to A when B received certain butts of sack from C. *Before* B had received these butts, A demanded from B the bag of money, B had it in hand but refused to deliver it, and A brought trover against B. The issue was whether, on those facts, trover lay.

(2) Some of the judges thought, or were inclined to think, that the plaintiff had mistaken his remedy, — that he should have brought detinue, not trover. There was at that time some feeling that trespass, trover and detinue should each reign supreme in a defined domain of its own, and that trover should be "kept in its place." Render unto detinue the cases that belong to detinue. In the course of time this thought has entirely faded out of the picture. The judges have allowed trover to invade the domain of detinue, just as they also have allowed trover to invade the domain of trespass. Trover came to hold the center of the stage, with trespass in an important place to the right, and detinue in a definitely less important place to the left.

(3) There was much debate as to whether a "denyer" *could* be a conversion. Was it a misfeasance? "There ought to be an Act done." "In no case you shall have a man to be a Trespasser upon the case without some Act done." (The reader should not forget that trover was an action upon the case p. 110.)

(4) But at least some of the judges thought there *might* be that kind of a conversion. They expressed that thought — not very happily — by saying that the demand and refusal would be *evidence* of a conversion. They were cautiously not committing

[10] 2 Buls. 306 (1614). See also 10 Co. f. 56.

themselves to the idea that demand and refusal constituted a conversion, but they did not close the door to the possibility that there *might* be that kind of a conversion. If there was a demand and refusal, the court would listen. It would consider fully all the facts of that particular case, and then decide whether there was, or was not, a conversion.

In the course of time it became clear law that a tortious withholding, evidenced by a demand and refusal, *might* be a conversion. Indeed, the bulk of conversion cases long consisted, and still consists, of cases where the plaintiff alleges that the defendant tortiously withheld.

(5) On the facts in *Isaack v. Clark,* there was no conversion because the " denyer " was *justified.* On the facts, B was under no duty to surrender the bag of money to A until he received the three butts of sack. All the judges agreed on the result. A modern court would take such a case in its stride.

(6) B had kept his fist closed on that bag of money. B had the *ability* to surrender, if he were so minded. He just *would* not surrender. It was a case of " would not," not a case of " could not." We are confident that all the judges regarded it as *obvious* that to make a conversion out of a " denyer " the defendant must have hung on to something which he could have surrendered if he had been so minded. Some of the judges seem to have thought that the " denyer " was no misfeasance *even* if B had the moneybag in his hand; not one of them would have advocated the idea that a " denyer " *in vacuo* was a misfeasance. They did not discuss that because it never occurred to any one of them that there was anything to discuss.

Later authorities confirm what we have said in (6). Thus, Blackstone said of trover: " The action can be brought against any man, who *had in his possession* by any means whatsoever the personal property of another . . . and refused to deliver them upon demand." [11] (Italics supplied.) In *Edwards v. Hooper,* Baron Parke said: " There cannot be an effectual demand and refusal *unless the party has at the time possession of the goods,*

[11] Comm. Book III, p. 111.

and has the means of delivering them up."[12] (Italics supplied.) Professor Holdsworth says: "The essence of conversion is a positive misfeasance on the part of the defendant. . . . The law still [that is, at the time Professor Holdsworth was writing] holds to the view that there can be no conversion, and therefore no cause of action in trover, without a positive act of misfeasance. . . . We have seen that to constitute a conversion a positive act of misfeasance was necessary. We have seen that, by means of the rule as to demand and refusal, a large meaning was given to the acts which would amount to such a positive act of misfeasance. But we have seen that this meaning was never extended so as to cover, either a mere failure to deliver by a bailee or finder, or damages done by them to the goods by negligence or accident. Such acts do not constitute and never have constituted a conversion for which this action can be brought."[13]

To restate: Centuries ago the English courts adopted the conception that trover never lay except where the defendant had been guilty of an act of misfeasance, and they have never deviated therefrom. They at one time debated whether a refusal to deliver was not merely a nonfeasance, *even* where the defendant had the ability to deliver, if he were so minded. In time, they all adopted the conception that a demand and refusal *might* constitute a conversion. The rule that demand and refusal were prima facie evidence of a conversion was simply their cautious, perhaps unhappy, way of saying that such acts *might* constitute a conversion, — that a tortious withholding of the possession was one kind of a conversion. They would look at the circumstances of each case. Was the refusal justifiable or excusable? That was a question for the judges, not the jury, to answer. We believe that *all* English judges have regarded it as *axiomatic* that ability to deliver was an indispensable element in the "surrounding circumstances," if the defendant's conduct was to be held, on all the facts, to amount to a conversion.

This thought has also been adopted by American courts. Thus,

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12 11 M. & W. 363, 12 L. J., Ex. 304, 7 Jur. 378 (1843).

13 A History of English Law (second edition, 1937), Vol. VII, pp. 403, 407, 432.

in *Dearbourn v. Union National Bank*[14] the plaintiff brought trover for the alleged conversion of certain bonds left with the defendants as security or on deposit. The plaintiff had demanded them, and the defendant had failed to deliver. The court ruled that in trover, a demand and refusal make out a prima facie case (here the influence of *Isaack v. Clark* is shown), but that this prima facie case is rebutted by proof that the property demanded was not at the time of the demand in the defendants' possession or under their control; and that the evidence showed that at the time of the demand the defendants did not have the articles in question in their possession or under their control. Thus too, in *Hall v. Boston & Worcester R. R. Corporation*[15] the court ruled that "the action of trover is not maintained by proof of negligence, but only of misfeasance amounting to conversion."

We are not enthusiastic about expressing the result of the "withholding" cases in the terms of the difference between a misfeasance and a nonfeasance. The prayer books have made everyone familiar with the supposed difference between doing those things that we ought not to have done, and not doing those things that we ought to have done. But as a practical matter it is not infrequently very difficult to distinguish. When a mule balks, is he guilty of misfeasance or of nonfeasance? One is tempted on this topic to express the thought in terms of an exercise of dominion, — clearly he who has the property and hangs on to it is exercising a dominion.

But we think that the objection-proof way to express the thought is to say that the tort is a "withholding," and that, *in the nature of things, he who does not hold, cannot withhold.*

According to all the English authorities and to nearly all the American authorities (at least prior to Judge Cardozo's opinion in 1915 in *Wood v. Fisk*, pp. 226–229), there was no tort of "withholding" unless, at the time of plaintiff's demand, defendant had the *ability* to deliver the thing demanded if he were so minded. We believe it to be fundamental that, in the six species of con-

[14] 58 Me. 273 (1870).

[15] 14 All. (Mass.) 439, 92 Am. Dec. 783 (1867).

version (p. 118), demand and refusal is irrelevant in all cases except those of tortious *withholdings* (second species).

We see no justification for asserting that a refusal *in vacuo* to deliver what the defendant has no ability to deliver is a *withholding* of the thing which is *not held*. The failure to deliver may be, and often is, a breach of a contract, but it is *not* a conversion. Therefore, if B, the pledgee, converts by a tortious transfer to C, and later A demands and B refuses, B is *not* guilty of a second conversion.

And, indeed, Judge Cardozo himself seems to us to have been of that opinion. But, as we shall see in Chapter IX, some of the New York judges have said, and even held, that there is *no* conversion in the tortious repledge cases unless there is a demand by A and refusal by B subsequent to the tortious transfer by B to C. We submit that this is plainly wrong.

We pass to some cases of withholdings by persons other than pledgees, which we give only for the purpose of supplying a background for Chapter VI which deals with tortious withholdings by pledgees.

Usually, the great controversy between the litigants in demand and refusal cases is over the question whether the plaintiff had the right to immediate possession at the time of the demand. *Demand and refusal cases are usually cases to try title.* The defendant is in possession, claiming title. The plaintiff, also claiming title, demands the property from the defendant, he refuses to give up the possession, and the plaintiff thereupon brings an action for conversion. The demand and refusal are merely the method by which the title question is brought before the court. Trover serves in such cases merely as a butler ushering in the litigants. The butler withdraws, and then the litigants are heard.

Now, the determination of the title question has usually nothing to do with the law of conversion. It will involve the decision of some point or points in the law of sales, or chattel mortgages, or wills, or gifts, or bankruptcy, or accession, or confusion, or adverse possession, or fixtures, or waste, or emblements, and so on and on.

Assume that the plaintiff has introduced evidence sufficient to justify finding (1) that the plaintiff demanded; (2) that the defendant had the ability to deliver if he were so minded; and (3) that he refused to deliver. The judges have for centuries followed the thought expressed in *Isaack v. Clark* (p. 119) that these facts raise a prima facie case of conversion. The judges will then listen to see if such refusal was, on the facts of the case, either *justifiable* or *excusable*.

A refusal, *reasonably qualified*, is a justifiable refusal. Thus, if B finds some chattel and A, who is in fact the owner, demands it, B is not a converter if he does not forthwith deliver it to A. It is reasonable that he should make inquiry as to whether A is the owner.[16] Thus too, where the defendant was a servant and refused to deliver the goods without first consulting his master.[17]

Suppose the goods of A get into the possession of B, who has no right in them. B bails the goods to C for safekeeping. A discovers where they are and demands them from C. C is in a difficult position. He voluntarily accepted the bailment from B, and, until A has asserted himself and demanded the goods, he must treat B as his bailor. But if A does assert himself, he cannot protect himself by referring A to B. "A bailee can never be in a better situation than the bailor. If the bailor has no title, the bailee can have none, for the bailor can give no better title than he has. The right to the property may, therefore, be tried in an action against the bailee." [18]

A bailee who misdelivers is a converter; therefore if A is not in fact the owner and C delivers the goods to him, B can hold C as a converter. But if, on the other hand, A is in fact the owner and C refuses to deliver the goods to him, A can hold C as a converter. If C takes it upon himself to decide between A and B, he does so at his peril, and, even if he acts in good faith and with due care, he is a converter if he yields to the wrong man.

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16 *Green v. Dunn,* 3 Camp. 215n. (1811). See also *Dent v. Chiles,* 5 Stew. & Port. 383, 26 Am. Dec. 350 (Ala., 1834).

17 *Alexander v. Southey,* 5 B. & Ald. 247 (1821).

18 By Lord Tenterden, C.J., in *Wilson v. Anderton,* 1 B. & Ad. 450, 9 L. J. K. B. (o.s.) 48 (1830).

In such a situation C *ought* to be allowed to save himself by filing a bill of interpleader (or a statutory action in the nature of a bill of interpleader) and then the court, not he, will decide between A and B. Courts and legislatures have been surprisingly slow to give such relief in all the cases where it ought to be given.[19]

Today in many (not all) jurisdictions a person in C's position may find relief by a bill of interpleader or a statutory proceeding in the nature of a bill of interpleader. Where relief can be sought through an interpleader and some C asks for time until he has opportunity to consult his attorney, that is a reasonably qualified refusal; and if his attorney advises him to file a bill of interpleader (or a statutory action in the nature of a bill of interpleader) and he directs that that be done, he will be justified in continuing to refuse to deliver up the property until there has been a reasonable opportunity to file such bill (or action).

Suppose that the defendant is not a bailee, but is a servant. We have already seen (p. 124) that a servant may take time to consult his master. If the master, after being consulted, directs the servant to make an unqualified refusal, and he does so, the master may be a converter. If so, would the servant also be a converter?

This is a point not yet clear upon the authorities. It may be urged in behalf of the servant that no one is a converter unless he comes into possession of the property, and that a servant has "mere custody" and not possession, the possession being, by construction of law, in the master. To this it may be answered that the rule of law that a servant's actual possession will be demoted into "mere custody" and that the master, not the servant, will be "deemed" to have the possession, was adopted for the purpose of giving the *master* the rights based on possession as against third persons (and the servant himself), and was never intended to be *a shield to the servant against liabilities to third persons.*

But it may further be urged in behalf of the servant that the courts would regard the master, not him, as the proper person

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19 See Chafee, Cases on Equitable Remedies, pp. 40–63, and 30 Yale Law Review 828–840.

to bring a bill of interpleader (or an action in the nature of a bill of interpleader). We know of no case where a servant has been allowed to file a bill of interpleader (or an action in the nature of a bill of interpleader) respecting goods of which he had the manual possession.[20] If his master tells him not to deliver, and a third person demands that he shall deliver, we do not believe that any court would allow him to bring a bill of interpleader (or an action in the nature of a bill of interpleader) against his master and the third person.

Moreover, it is not only unreasonable to expect the servant to disobey his master, but it is good public policy that servants should be encouraged to obey rather than to disobey. It is true that in *Stephens v. Elwall*,[21] a case where the defendant had tortiously disposed of the property, Lord Ellenborough said: "It is no answer that he acted under authority from another, who had himself no authority to dispose of it." But in *Mires v. Solebay*,[22] the defendant, a servant of one Marwood, refused to deliver up sheep to the plaintiff. Both the plaintiff and Marwood claimed title to the sheep. The defendant was held *not* guilty of conversion. The court said: "The action will not lie against the servant; for it being in obedience to his master's command, though he had no title, yet he shall be excused. And this rule Justice Scroggs said would extend to all cases where the master's command was not to do an apparent wrong; for if the master's case depended upon a title, be it true or not, it is enough to excuse the servant; for otherwise it would be a mischievous thing, if the servant upon all occasions must be satisfied with his master's title and right before he obey his commands."

We submit that the doctrine of *Mires v. Solebay* is more reasonable, and more in accord with sound public policy than the doctrine of *Stephens v. Elwall*. Due regard for the rights of the plaintiff does not require that he should be able to hold both

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[20] The cases of *Pearson v. Cardon*, 2 Russ. & M. 606 (1831) and *Dungey v. Angove*, 2 Ves. Jr., 304 (1794) are worth looking at.

[21] 4 M. & S. 259 (K. B. 1815).

[22] 2 Mod. 242, 244 (C. P. 1676).

master and servant. But we repeat that the law is not yet clear upon the point.[23]

If *Mires v. Solebay* is law, then we have *a* case where the defendant had the ability to deliver, the plaintiff had the right to immediate possession, there was an unqualified refusal, and yet the defendant was not a converter. The wrong from the plaintiff's point of view was serious, but the circumstances were such that the defendant ought to be *excused.* The refusal was not justifiable, but it was *excusable. Rarely,* will an unjustifiable refusal be an excusable refusal. But we believe that there are a *few* such cases. For another case, see pp. 179–183.

III. *Tortious transfers by persons* other *than pledgees.*

A defendant who transfers the possession is said to "dispose" of the property. When the judges say that the defendant "disposed" of the property, they mean that, after coming into possession of the property, he passed that possession on to some third person. When A, the owner, comes to B, the defendant, seeking his property, the defendant can only say: "I did have it. But I passed it on to C. You will have to go and chase it, and get it from C (if you can)." And when the owner comes to C, he may find that C has passed it on to D, and so on and on. B has set A's chattel afloat on a sea of persons, strangers to A. A must go and chase it. Such acts have been repeatedly held to be conversions.

In *Hoffman v. Carow,*[24] A's property got into the possession of B who had no authority to sell it. B delivered the possession to C, an auctioneer. C sold to D and delivered possession to D, and paid the proceeds (less his commission) to B. C acted in good faith and with due care. Nevertheless, he was held liable to A for the full value of the property. Senator Verplanck said: "In this instance the rule falls hardly upon innocent and honorable

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23 See *Singer Manufacturing Co. v. King,* 14 R. I. 511 (1884), and cases there cited; *Elmore v. Brooks,* 6 Heisk. 45 (Tenn. 1871); and, particularly, *Leuthold v. Fairchild,* 35 Minn. 99, 111, 27 N. W. 503, 28 N. W. 218 (1886), a decision by that reliable, shrewd judge, Mitchell, the Minnesota Mansfield (p. 138 note 38).

24 22 Wend. (N. Y.) 285, 319 (1839).

men; but looking to general considerations of legal policy, I cannot conceive a more salutary regulation than that of obliging the auctioneer to look well to the title of goods which he sells, and in case of feloniously obtained property, to hold him responsible to the buyer or the true owner, as the one or the other may happen to suffer."

Does the same principle apply to stock and bond brokers? If what such broker has sold is not a negotiable instrument, yes. But usually what he sells is a negotiable instrument (either by force of judicial decision or by force of some statute, p. 24). In such cases, the decisions are not numerous. We may have missed something, but, so far as we know, there are only three states, — Maine,[25] Massachusetts,[26] and New York,[27] in which the courts have made a decision upon the liability of a bona fide broker for a rascal *seller*. It is vital that the question whether a bona fide broker for a rascal seller is liable should not be confused with the very different question whether a bona fide purchaser, or a bona fide agent for a bona fide purchaser, is liable.

Maine held the bona fide agent for a rascal seller liable. Massachusetts and New York held him not liable. The present poll of the states therefore is as follows: For liability, one; against liability, two; not voting, forty-five.

This is a question dwarfing in practical importance the question of the liability of an auctioneer or other broker who sells an ordinary chattel as agent for a rascal seller. We submit the following:

1. In the Massachusetts case, the court cited the previous decision of *Spooner v. Holmes*.[28] But in that case the defendant had taken the stolen bonds in exchange as agent of his principal. His principal would of course have been protected if he had himself done the act (there was no question of his good faith), and we not only concede but urge that, whenever the principal would

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[25] *Kimball v. Billings,* 55 Me. 147, 92 Am. Dec. 581 (1867).

[26] *Pratt v. Higginson,* 230 Mass. 256, 119 N. E. 661, 1 A. L. R. 714 (1918).

[27] *Gruntal v. U. S. &c. Co.,* 254 N. Y. 468, 173 N. E. 682, 73 A. L. R. 1337 (1930).

[28] 102 Mass. 503, 3 Am. Rep. 491 (1869).

be protected if he had acted himself, a bona fide agent for him should also be protected. The court in *Pratt v. Higginson* did not note that in the case at bar, the defendant was not the bona fide agent of a bona fide purchaser, but was the bona fide agent of a rascal *seller*. The New York court followed the lead of the Massachusetts case, and seems to have thought that, because a bona fide purchaser would obtain a good title, it followed that a broker for the seller should be immune from liability (two very different questions). Bona fide agents for rascal *sellers* were given as full protection as though they were bona fide *purchasers*.

2. We have heard the argument made in support of the result of the Massachusetts case that there is such a strong public policy in favor of the free circulation of negotiable instruments that every facility for marketability should be extended, since it will encourage purchases if the *purchasers* are assured that they will not be delayed by a cautious inquiry by brokers when *later* they may decide to *sell*.

But do purchasers of such instruments desire that? What does encourage free circulation, and encourages it mightily, is that bona fide purchasers may feel assured that they *acquire* an indefeasible title. But once they have acquired such title, they are owners, and, like all other owners, are *now* much interested in having their titles protected. Obviously, a rule of law that requires brokers for sellers of negotiable instruments " to look well to the title of goods which he sells " (the language used by the New York court in a case dealing with the liability of a broker of an ordinary chattel, our p. 127), and thereby blocks the rascal from getting CASH, the hope of which tempted him to steal, affords a good deal of protection to owners of negotiable instruments.

True it is, that some honest holder may desire quickly to turn his property into cash, and may be embarrassed by caution on the part of the broker whom he asks to sell for him. But almost all honest men have such relations with some broker that, as a practical matter, they will not be exposed to delay. The probing question is whether it is more to the advantage of honest men, owners of negotiable instruments, as a class, to have brokers cau-

tious as to the persons for whom they act in selling, than to have them ready to sell without much inquiry. We are confident that purchasers of negotiable instruments, if considered as a class, would feel that the advantage to them in a rule of law which blocked rascals from getting cash definitely outweighed any slight disadvantage to which they themselves might, conceivably, be exposed if they desired to sell. Few men object to having the door of their house locked and bolted at night because they may want before morning to leave the house quickly.

Note the results which have attended the registration of titles under so-called Torrens Acts. These acts are supposed not only to give absolutely safe titles but also to promote the marketability of titles, through provisions for protecting bona fide purchasers of certificates. In *Eliason v. Wilborn* [29] A held a certificate, and entrusted it to B. B forged an indorsement, and procured the Register to issue a new certificate in B's name. B sold this to C, a bona fide purchaser. C prevailed over A. The court said that A had " nothing but a Torrens title. . . . They knew they were liable to lose without having parted with it."

If the law is such that bona fide purchasers are exposed to such large risk of losing their title such fact tends not for, but against, an abundance of purchasers for such property, and therefore does not promote, but does retard, marketability.

3. Turn for a moment to the law as to railroads. B steals A's chattel, and brings it to C, a railroad, for transportation. C believes, and reasonably believes, that B is the owner, and transports the chattel according to B's directions. A discovers the facts and demands the chattel from C. Has C a lien on the chattel for the transportation charges? England answers that question " Yes "; but America answers that question " No."

Now, it may be urged in such a case that the railroads perform an indispensable service to the community and, therefore, that they should be protected against loss so long as they act in good faith and with due care. American courts have, nevertheless, thought it wise to protect owners, and we think that all will con-

[29] 281 U. S. 457, 50 Sup. Ct. 382, 74 L. Ed. 962 (1930).

cede that the adoption of this rule of law has had no crippling effect upon American railroads. Plenty of railroads have become bankrupt, but this rule of law has not even been a contributing cause.

Similarly, we are confident that if brokers in negotiable securities (in negotiable form) are held to the same liability as that of brokers dealing with ordinary chattels, this will have no crippling effect upon the brokerage business. We do not believe that a single brokerage house would go out of business because of the adoption by the courts of such a rule. The brokers would go right on doing business at the old stands. But there would be two consequences flowing from the adoption of such a rule. The first would be that the brokers would have a heart-to-heart talk with the members of their staffs, to impress upon them that they just *must* not fall for plausible customers. The second would be that most if not all of the brokers would insure against the risk flowing from such a rule of law. It is not unusual at the present moment for stock and bond brokers to insure against some risks of the business, and it may well be that the terms of some policies of insurance now in force are broad enough to cover such a case. But assume not. Assume that the adoption of such a rule would make it prudent for a broker to take out insurance against the risk. If so, it would be entirely legitimate for the cost of the premium for such insurance to be given full consideration in determining what are reasonable brokers' charges. Sooner or later the customers, as a class, will pay. And the customers, as a class, *ought* to pay. The cost will work back to just the place where it ought to be.

Therefore, the question is this: Should persons who wish to buy and sell negotiable instruments (in negotiable form) be entitled to get slightly lower brokerage charges at the expense of owners of such securities which have got into the hands of rascals?

We do not believe that answering " No " to that question would have any more disastrous effect upon the brokerage business than a passing cloud has upon the sun.

If our economic analysis is correct, then, we submit, there is

scarcely room for a difference of opinion among intelligent men as to what is the right answer to the main problem.

There is always a strong public policy for the protection of property rights. There may be some other public policy which outweighs it. There *is* an outweighing public policy in favor of the bona fide *purchaser*. There is *not* an outweighing public policy in favor of the bona fide agent for the rascal *seller*.

4. If the thing sold is an ordinary chattel, Massachusetts and New York agree with the other states that adequate protection of property rights requires exposing the broker to liability. We think (although it is a question justifying a difference of opinion) that the courts have made the right answer. Anyway, they have made that answer, and, moreover, they show no disposition to change that answer.

If that answer stands, then we submit that it is not sensible to impose such liability upon a broker in favor of the owner of ordinary chattels, and not to impose it upon a broker in favor of the owners of negotiable instruments (in negotiable form).

Look at the matter as a practical matter. A owns jewels. B steals them. C, the bona fide broker for B, sells them to D, a bona fide purchaser. A has a good many strings to his bow: (a) He may sue B. Let us, however, throw away that string as rotten, — as a practical matter it will probably be unreliable. (b) He may demand the jewels from anyone (D, or anyone else) who has the possession, and, if they are not surrendered, may replevy them. (c) A may, in Massachusetts, hold D (who will usually be financially responsible) liable as a converter and recover the fair market value on the date of D's purchase. (d) In New York, if D refuses to surrender *or* if D sells and delivers to another (see *Pease v. Smith,* our p. 137), A may recover from D the fair market value as of the date of the refusal, or the delivery by D (as the case may be). (e) If E buys from D, A will have remedies against E, similar to the remedies spelt out above, as against D. And if F buys from E, similar remedies, and so on and on.

What makes such a case as *Hoffman v. Carow* (p. 127) a close

case is the fact that, even if A should not be allowed to hold C as a converter, A would *usually* have *other* adequate remedies whereby he might protect himself (although *not* always; in that "not" is the pith of the justification for the rule in the ordinary auctioneer case).

But now suppose that the subject matter of the sale is bonds payable to bearer. D, the bona fide purchaser, gets a good title. By operation of law the title is taken from A and vested in D (p. 33). A is not merely put in a position where he must go and chase after his property. He now has no property to chase. His only possible remedies are against the rascal (throw away that rotten string), and C. Under these circumstances, Massachusetts and New York rule that, although A may hold C liable as a converter when C aids a transaction which simply sets A's jewels (still A's jewels) afloat on a sea of strangers, A may *not* hold C liable as a converter when C aids a transaction which *destroys* A's title to the property. In our opinion such a difference in result does not make sense.

Turn to the Bible, that fount of wisdom and treasure-house of dignified, depicting diction. In the twelfth verse of the thirteenth chapter of the Gospel according to Saint Matthew, it was written: "For whosoever hath, to him shall be given, and he shall have more abundance: but whosoever hath not, from him shall be taken even that he hath." Nineteen centuries flashed by; and then, in cases involving the abundance of remedies available to a wronged owner, the Massachusetts and New York courts fulfilled the prophecy.

5. We do not whet our rapier when we smell the blood of a stockbroker. We are disposed to let the dead past bury its dead. Stock and bond brokers perform an indispensable service. True, they are not the backbone of the nation, — the producers are the backbone. But those who only assist others to buy and sell also serve. They are an important leg bone, and the nation would be maimed if it lost that bone.

But such brokers ought not to receive special favors denied to brokers in other kinds of property, simply because their busi-

ness is in a kind of property to bona fide purchasers or pledgees of which the law, for compelling reasons of public policy, grants special favors.

We should like to give a not unfriendly poke at stock and bond brokers by putting to them this question: " Are you not *just a bit* like the legendary goldsmith who after working in gold for many years came to think that he himself was precious metal? "

The response which a particular broker will make to that question will depend on the caliber of the broker. Such brokers are usually of good-sized caliber. And we are confident that at least some of them will be big enough to say (and say it with a smile): " There may be *just a bit* of something in what you say."

6. There are some overseas cases which consider the liability of bona fide agents for sellers or purchasers in market overt. These cases are not decisive but they have large persuasive value. It is most unfortunate that counsel did not bring them to the attention of the court either in the Massachusetts case or in the New York case.

B steals A's chattel, and sells in market-overt to C, a bona fide purchaser. In England for centuries the law has protected C. By operation of law the title is taken from A and vested in C (p. 23).

The justification for so depriving A of his property is public policy. The law protects C because it is to the advantage of commerce that such a person should be protected. C does not win, so to speak, on his own merits. The public need is the decisive force back of a policy of which C is a beneficiary. We submit that there is a persuasive analogy between the protection accorded to a bona fide purchaser of an ordinary chattel in market-overt for reasons of public policy and the protection accorded to the bona fide purchaser of a negotiable instrument in negotiable form for reasons of public policy.

Now, in *Delaney v. Wallis,*[30] A's chattel was stolen by B. B took it to C, a " salesmaster," in a market-overt. C negotiated a sale to D, and delivered to D. C acted in good faith and with

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[30] L. R. 14 Ireland (Ex. Div.) 31, 15 Cox C. C. 525 (1883).

due care. A was allowed to hold C liable as a converter. C had aided his principal to do an act which it was unlawful for his principal to do.

Hollins v. Fowler,[31] is probably the most famous of all the cases in the law of conversion. It is so important that we devote appendix E to it.

B had by fraud induced A to part with the possession (*not* the title) of some bales of cotton owned by A. B sought to turn them into cash. C, acting in good faith and with due care, purchased for D from the rascal B, and shipped the cotton to D. Under English law, D was unquestionably a converter, since he acquired possession and claimed that he was the owner. Was C, the bona fide agent, *also* liable as a converter? In a powerful opinion, Mr. Justice Blackburn reached the conclusion that he was. He had aided his principal to do an act which it was unlawful for his principal to do.[32]

Now, it is most interesting to note that Mr. Justice Blackburn in the course of his opinion carefully considered what the position of C would have been *if* Parliament had seen fit to make the Liverpool cotton market a market-overt. If that had been done, he thought that C would not have been liable, for in *such* case he would have been aiding his principal to do an act which it was lawful for his principal to do. But, as Parliament had not done this, C was liable.

Put these two cases side by side. They are in perfect harmony. Whether a bona fide agent is, or is not, immune from liability as a converter depends on whether he is, or is not, aiding his principal to do an act which it is lawful for his principal to do. Like principal, like agent.

Now, in the Massachusetts and New York stock and bond broker cases, C the bona fide agent was *not* agent for the bona fide *purchaser*. That is the point. Do not miss that. He was agent for the rascal *seller*. The Massachusetts and New York courts did not, we submit, give as much consideration to this important fact as it merits.

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[31] L. R. 7 H. L. 757, 764 (1875).

[32] See, *accord, Rice v. Yocum,* 155 Pa. 538, 26 Atl. 698 (1893).

7. In the New York opinion the court speaks of the well known case of *Hibbs v. Brown*.[33] Is that decision relevant? We think not. Even if it were, the lead of that case ought not to be followed. There is a full discussion of that case by the author in Corporate Advantages Without Incorporation, pp. 477–500.

8. Both the Massachusetts and the New York cases dealt with bonds payable to bearer. Such bonds derive their negotiable character from judicial decision, — from the common law. But shares of stock, bills of lading and warehouse receipts indorsed in blank owe their negotiable character to statutes (p. 25). Therefore, if cases shall hereafter arise dealing with sales by bona fide brokers for rascal sellers of such shares of stock, bills of lading or warehouse receipts, it will be incumbent upon the court to consider and decide whether the legislature in passing such statute had any intent other than to protect bona fide *purchasers* (and bona fide pledgees and so forth). Did it *also* intend to hedge with immunity the bona fide agents of rascal sellers?

We give two more cases dealing with tortious transfers by persons who were *not* pledgees.

In *Hall v. Boston & Worcester R. R. Corporation*,[34] the defendant held, subject to plaintiff's order, certain barrels of flour. By mistake these were delivered to some stranger without the authority of the plaintiff. Was the defendant a converter? The defendant insisted that that depended upon the amount of care it was bound to exercise, and the degree of negligence of which it was guilty. But the court said: "A misdelivery of property by any bailee to a person unauthorized by the true owner is of itself a conversion, rendering the bailee liable in trover, without regard to the question of due care or degree of negligence. This is a well established legal principle, applicable to every description of bailment. The action of trover is not maintained by proof of negligence, but only of misfeasance amounting to a conversion. And

[33] 190 N. Y. 167, 82 N. E. 1108 (1907).

[34] 14 All. (Mass.) 439, 92 Am. Dec. 783 (1867).

a delivery to an unauthorized person is as much a conversion as would be a sale of the property, or an appropriation of it to the bailee's own use. In such cases neither a sincere and apparently well founded belief that the tortious act was right, nor the exercise of any degree of care, constitutes a defence even to a gratuitous bailee."

In *Pease v. Smith*,[35] A's property was stolen by B, and sold to C, who in turn sold to D. Both C and D were bona fide purchasers. D then sold and delivered the property to E. A sought to hold D liable for a conversion.

Now, in England and most states in this country, a person in the position of D would become a converter the instant he took the property into his possession claiming to be the owner. This is the sixth (a) species of conversion. See p. 118. But in New York and a few other states the courts have adopted what seemed to them a milder rule under which the taking of the property by the defendant into his possession under claim of title, *without more*, is not a conversion. In *Pease v. Smith* the court held D liable as a converter, *not* because he had taken the property into his possession, claiming title, but because he had at a subsequent time *transferred the possession to E*.[36]

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[35] 61 N. Y. 477 (1875).

[36] A question which merits careful consideration is this: Will the " milder " rule prevent the bona fide purchaser from acquiring title to the property after a lapse of time by adverse possession? If it does prevent this, there is a basis for contending that, all things considered, the majority rule is more advantageous for bona fide purchasers than is the New York rule.

Many persons believe that there are statutes which provide that, after defined periods of time (say, twenty years for land and six years for chattels), the title shall be vested in the possessor. And there are a few such statutes, but they are rare. The pertinent New York statute has no such provision.

How then does the adverse possessor of either land or chattels get title after a lapse of time? Take land. It is A's land. B tortiously takes possession and claims to be owner (land is allodial in New York). A at once has a cause of action against him. Therefore B's possession is disturbable by A. But twenty years go by. B's disturbable possession becomes an indefinitely undisturbable possession. The Plantagenet conception was that an indefinitely undisturbable possession *was* title, — you could not have anything better than that. *That* Plantagenet conception not only has survived but deserves to survive. It is sound, and it serves a useful purpose in a number of situations of which adverse possession is only one. The instant

Before leaving this topic it is to be noted that there are a few exceptions to the general rule that an unauthorized transfer is a conversion. There are not many, but there are a few.

See the suggestions of Mr. Justice Blackburn in *Hollins v. Fowler* (beginning at page 767 of the official report). Note also that if a customer in a shop leaves an article on one of the counters, and it is taken to the lost-and-found department, and later delivered, in good faith and in the exercise of due care, to a person pretending to be the owner, the shopkeeper is pretty surely not liable.[37] Note also the principle of *Leuthold v. Fairchild*[38] that

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that B acquires an *indefinitely undisturbable* possession (which he does at the expiration of the twenty years) that instant he acquires title.

The Statute of Limitations qualifies B to be an owner by changing his disturbable possession into an indefinitely undisturbable possession, but it is the common law conception of title, derived from the Plantagenet judges, which gives him title. B is *qualified* by the Statute to be admitted into the company of owners, but he *is* admitted by the common law. This being the way that title either to land or chattels is acquired under most Statutes of Limitations, it necessarily follows that the statutory period does not begin to run until A has a cause of action against B. It is A's chattel. B is a bona fide purchaser from some rascal who has got hold of it. Under the New York rule A has no cause of action against B. Neither an action for conversion nor replevin lies. Six years go by. A demands, B refuses. A then has his option either to pursue his remedy *in personam* and recover the value of the chattel at that time (which may be greater or less than its value at the time of the bona fide purchase) or to pursue his remedy *in rem* and replevy.

Indiana is one of the states that follow the New York lead as to the "milder" rule, and A has been allowed to replevy from B although B had been in adverse possession for more than six years. *Torian v. McClure,* 83 Ind. 310 (1882).

[37] See *Heugh v. London and N. W. Ry. Co.,* L. R. 5 Exch. 51, 39 L. J., Ex. 48, 21 L. T. (N.S.) 676 (1870), and the reasoning in *Morris v. Third Avenue R. R. Co.,* 1 Daly (N. Y.) 202 (1862).

In an analogous case, where the plaintiff had started the trouble by thrusting the possession upon the defendant, see the excellent dissenting opinion of Lehman, J., in *Cowen v. Pressprich,* 117 Misc. (N. Y.) 663, 676, 192 N. Y. S. 242, 249, which was adopted by the Appellate Division in 202 App. Div. 796, 194 N. Y. S. 926 (1922).

[38] 35 Minn. 99, 27 N. W. 503, 28 N. W. 218 (1886). The opinion was by Mr. Justice Mitchell (1832–1900). Graduated from Jefferson College, Pa., 1853; admitted to the Virginia Bar, 1857; and moved thereafter to Minneapolis; judge of the 3rd Judicial District of Minnesota, 1874–1881; Justice of the Supreme Court of Minnesota, 1881–1899. We appraise him as one of the most reliable, shrewd, wise judges that this country has produced, and one of the three most excellent judges from the grain-producing states. He is entitled to be regarded as the Minnesota Mansfield.

WILLIAM MITCHELL

Justice of the Supreme Court of Minnesota

those who do specific acts by direction of a superior (whether that superior be called a "master," or a "principal") are not liable as converters.

IV. *A discussion of "compensatory" and "involuntary-purchase" damages, as preliminary to the discussion of the rights of persons who purchase stocks on margin in Chapters VIII to X inclusive. Our contention is that a tortious repledge is both a conversion and a breach of contract, and that the pledgor should have a real, and not merely nominal, option to sue in tort or contract, and that, if he elects to sue in tort, the damages should be "involuntary-purchase" damages.*

Some courts, while paying lip-service to the rule that a pledgor does have an option, nevertheless in effect deny it by holding (1) that the damages should be the *same,* no matter what the form of action is (a seductive suggestion), *and* (2) that the measure of damages should be the contract measure rather than the conversion measure.

We think it is most important to guard against a shearing of hair by that Delilah-like seductive suggestion. The suggestion does certainly look beautiful when first it meets the mental eye.

Those who desire that the tort measure of damages shall be suppressed in favor of the contract rule of damages say that the "compensatory" contract damages are more fair and equitable, more in accord with substantial justice, than the "punitive" damages for conversion.

We undertake to *demonstrate* to any reader who is open-minded and will lend us his ears that there is *less than nothing* in this.

To drive home his point, the author will first speak of two cases in which he was counsel years ago to show how great is the danger, as a practical matter, that the so-called "compensatory" damages will prove to be in fact "chiselled" damages, or, worse still, "sadly shrunken" damages. We are building a battering ram to be used later. *Wood v. Fisk delendum est.*

First case. The client had been discharged from an important position, which under a contract he was to hold for over two years

more. The defendant claimed that the discharge was for cause. At the trial before a judge and jury there was conflicting evidence as to whether there was, or was not, cause. The plaintiff testified that he had sought in vain to obtain another like position. He was vigorously cross-examined on this.

Counsel for the defense said in his address to the jury that, even if the plaintiff had been discharged without cause, he had suffered no damage. " Is there one man among you twelve good men and true who would have been so sprawlingly supine, so pathetically inadequate to meet the situation as *this* man proved himself to be? There is not one among you who would not have been so alert, so up-and-coming, that he would quickly have found not simply as good a position but a better position, — for, gentlemen of the jury, you will have noticed that the plaintiff claims, and loudly claims, that he is a man of great ability, of extraordinary ability."

In due time, the author had his turn: " I am sure that you have all enjoyed as much as I did, watching my brother, the very able and agile counsel for the defendant, with his bright eyes and bushy hindsight, leap from branch to branch in the tree of might-have-been. I am surprised, greatly surprised, that with his alert mind — his alertissimo mind — he should have been guilty of *gross* negligence toward that client who had put implicit confidence in his ability. (Pause.) He ought to have filed a counterclaim in behalf of his client for the opportunity to rise higher in the world which his client had laid at the plaintiff's feet."

The laugh that went up preceded a not unsatisfactory verdict. The point is that it took a good laugh to erase the deep furrows from the brows of the jurymen.

We are of course not urging that there should be no duty on the plaintiff to act reasonably to keep the damages down. Our point is that hindsight is so much better than foresight, and that an adroit attorney not infrequently succeeds in fuddling the jurymen and in inducing them to think that the plaintiff ought to have acted in the manner in which they themselves would have acted *in the light of all the facts which counsel for the defendant has now called to their attention,* forgetting that if they had been in

the plaintiff's place they might not have extricated themselves from the hole any better than he did.

If A sues B for breach of contract, the defendant is allowed to say to the plaintiff: "Yes. I did wrong to you. But *tu quoque*. You did wrong to me by not diminishing the effects of my wrong to you. I put you in a hole, but you did not get out of the hole quickly." Always, in breach of contract cases, this *tu quoque* lurks and not infrequently results in what may fairly be characterized as "chiselled" damages.

Second case. This case is in the reports.[39] B, a Massachusetts man, with large experience in running summer hotels, decided to make a modest venture upon running a hotel in Florida in the winter season. He leased from A for one year a small hotel at West Palm Beach. In the lease A covenanted to renew, on request, for two years more at the same rental. During the year, A transferred the reversion to C, giving C notice of the lease. B and C were unable to come to terms, — C was willing to give a new lease but only at an increased rent. B later, in due time, made upon A a demand for a renewal. A expressed regret, but, under the advice of counsel, took the position that she (she was the executrix under the will of Joseph Jefferson) was under no liability to B. B sued A for breach of covenant.

At the trial before a judge and jury, the plaintiff produced his books showing in detail cash receipts and expenditures for the year. There was a favorable balance of just over $900. The plaintiff testified that he had conducted a hotel at Onset in Massachusetts for fourteen years and had been in the hotel business for over twenty years; and that at the time of the negotiations for the lease he told the defendant's agent that he did not expect to be able in the first year to do more than make his expenses; that the business should double in the second year and in the year to follow should increase one third; that he estimated the receipts for the following two years at $8,000 a year, and the expenditures at $6,000 a year; and that in his judgment the money value of

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39 *Neal v. Jefferson*, 212 Mass. 517, 99 N. E. 334, 41 L. R. A. (N.S.) 387, Ann. Cas. 1913D205 (1912).

the leased property for two years at the stipulated rent ($1,000 a year) to a person in his position engaged in his special business would be $2,000 a year or $4,000 for the two years, and that this would be clear profit.

At the close of the evidence the defendant asked for several rulings. Among these were: " 13. The measure of the damages, if any, which the plaintiff is entitled to recover is the difference between the amount of rent which would have been payable by him under the renewal lease and the rental value of the premises. 14. Neither the profits of the plaintiff for the year November 1, 1909–November 1, 1910, nor the prospective profits in the two following years, are evidence of the rental value of the premises. 16. In determining the rental value of the premises covered by the lease for the years November 1, 1910–November 1, 1912, you should not consider the plaintiff's prospective profits. 21. In determining the rental value of the premises covered by the lease for the years November 1, 1910–November 1, 1912, if you consider any prospective profits of the plaintiff, you must consider in reduction of those profits, any opportunity the plaintiff may have had to obtain the Hotel Jefferson for those years from [C]."

The judge refused to make any of these rulings. The jury returned a verdict for the plaintiff in the sum of $4,116, and the defendant brought the case before the Supreme Judicial Court of Massachusetts.

There was a point about covenants. Counsel for defendant urged that the case was analogous to a case decided in another jurisdiction where A covenanted with B, an adjoining landholder, to maintain a fence on the boundary line, and then sold his land to C. In that case it was held that, if C did not keep up the fence, B had no cause of action against A. The brief of counsel for A was largely devoted to this point. The author felt confident that the fence case was distinguishable. Still there was, no doubt, a basis for a plausible argument.

The Supreme Judicial Court had that case under advisement for several months. Finally a decision was handed down overruling the exceptions. It appeared from this opinion that the court had not been unanimous. The court consisted of seven mem-

bers. Ordinarily only five participated in making a decision. But if the five were divided, three and two, then the other two justices would be called in. In this case all seven judges had participated.

The opinion was written by Mr. Justice Sheldon. Shortly afterwards, the author happened at some dinner to sit next to him. The author expressed his curiosity as to what it was that had divided the court. Was it proper to ask? Mr. Justice Sheldon said that such an inquiry might under some circumstances have to remain unanswered, but that he saw no reason why he should not, in this particular case, state the facts. The Court had been unanimous against the defendant on the covenant question, but three of the five judges who had first considered the case thought that there was such merit in the defendant's point as to prospective profits that the exceptions should be sustained. Precisely how the court had stood ultimately the author did not ask, and Mr. Justice Sheldon did not state; probably (but not surely) the plaintiff won only by a bare majority, four to three.

Now, ponder this case. There is, no doubt, a line somewhere between what may be called a "good guess" on the one hand, and a "mere guess," or "hunch," on the other hand. The twelve good men and true are sanctified guessers, but they are unsanctified hunchers. It is illuminating when one speaks of "compensatory damages" as *the* fair and equitable measure of damages to realize that it was the opinion (apparently rather stubbornly maintained) of some judges of so able a court as the Supreme Judicial Court of Massachusetts that the plaintiff was not entitled to hold the verdict which the jury had given him, and should only have been given some much smaller sum.

If the opinion of the minority had prevailed, the plaintiff would have received damages *far* below the amount which would have done substantial justice to him. And probably (although not surely) there were three judges out of seven in favor of sustaining the exceptions. It was a near thing.

Possibly the judgment of the author is influenced by the facts that he was counsel in the case and that he believed in the integrity, fair-mindedness and business capacity of his client. He thinks not. Years have passed, and he is no longer personally

interested. The case lies in his mind as an illustration of the anxious solicitude shown by many judges in an action for a breach of contract to see to it that the defendant, although plainly guilty of a breach of contract, shall not pay too much. In *criminal* cases it is, no doubt, most fitting that the court should be solicitous that *doubts of guilt* should be resolved in favor of the person who is charged with a crime. But we can see no sufficient justification for a court, in dealing with a defendant who has by due process of law been *found* guilty of a civil wrong, to be so solicitous, in determining the amount of damages to be paid by him in so-called "compensation," that the defendant shall not pay too much. We submit that, on the contrary, the court should be solicitous to see that, on the facts of the particular case, *adequate* compensation shall be received by the plaintiff.

In criminal proceedings, the dice are loaded in favor of the person charged with crime. That is as it should be. The defendant is as yet only *charged* with crime. Even with respect to civil wrongs, the dice are loaded from the start in favor of the wrongdoer, for the wronged plaintiff must either settle on the wrongdoer's terms or else embark upon a litigation the costs of which, even if he is successful, will come out of his own pocket. We have no quarrel even with that. The usual English rule of allowing the successful party to recover costs, as between solicitor and client, is certainly fairer as between the parties than is the American rule. But on grounds of public policy, the American rule is probably better for America. The pulse beats more slowly in England than it does in America; just as the pulse beats more slowly in New England than it does in California. Westward moves the quickening pulse. We think the percentage of Americans who get a thrill out of being a litigant, while not large, is definitely larger than the percentage of Englishmen who get a thrill out of it. Considering the possible volume of litigation, the existing American law as to costs probably operates as a useful brake.

But, if the proceeding is a civil proceeding, and the defendant has been, by due process of law, *adjudged guilty* of a tort or breach of contract, we can see no justification for rules as to

damages which will result in less than substantial justice to the wronged plaintiff. There is always a danger that the so-called "compensatory" damages will prove to be so small that they may fairly be characterized as "sadly shrunken" damages.

Compare "compensatory" damages with the "involuntary-purchase" damages payable by a converter.

We have often heard it charged that conversion damages are punitive. That is a false charge. Punitive damages are not unknown to our law, on its civil side. This fact is illustrated by "smart-money" damages. A is in possession of property, real or personal. B trespasses. The circumstances are such that the wrong may be fairly characterized as an outrageous wrong. The law *may* allow the plaintiff to recover, say, twice the amount of damages which he has actually suffered. Such law goes back to Plantagenet days, when a plaintiff in trespass *might* be regarded as half tortfeasee and half informer. (We do not divert to inquire either (1) whether such law was at one time desirable, or (2) whether, if so, it is still desirable.)

"Smart-money" damages do *enrich* the plaintiff. The *amount* of his assets is increased. But the damages for a conversion never enrich the plaintiff, — they never increase the *amount* of the plaintiff's assets. The damages for a conversion are "involuntary-purchase" damages. A owns a chattel of which the present market value in cash is $1,000. B converts. A is allowed to recover a judgment for $1,000 from B. *But* (and never forget that "but") the instant that B satisfies that judgment the title to the chattel in question passes by operation of law to B. The law does not permit A to eat his cake and have it too. It, so to speak, puts $1,000 cash into the right hand of A, but that same instant it takes the title of the chattel (worth $1,000 in cash at the time of the conversion) out of the left hand of A. So far as the amount of the assets is concerned there are cross entries on the balance sheet which exactly cancel each other. A is left with neither less nor more assets than he had just prior to the conversion.

It is true that the *form* of A's assets is changed. A owns, say, an automobile which he has had for some time. B converts. The market value of the automobile at the time was $1,000. A obtains

$1,000 cash, *but* he loses title to a $1,000 chattel the same instant in which he received the $1,000 cash. Conversion results are double-edged. They cut both ways.

This change in form may, or may not, be advantageous to A. It may be that he prefers $1,000 cash to the automobile. But it may be that he would have preferred to keep his automobile, and not be put to the necessity of either going without an automobile, or buying some other automobile with the $1,000 (or some other amount).

Moreover, as a practical matter, the amount of A's assets not only will not be increased, but will be *decreased.* That statement may surprise, but it is in accordance with the facts of legal life. A will have to pay out of his own pocket the expenses of the litigation. Assume that a reasonable attorney's fee in a particular case is $150. In America taxable costs are usually only a small fraction of the actual expenses of the litigation. The net result is that A is $150 worse off. He has lost title to a $1,000 automobile, and he has in his pocket only $850 cash.

What is meant by the " fair market value " of property? That is *not* an elusive phrase. It may be defined as follows: The amount in cash which would be agreed upon in a bargain between (a) a reasonably shrewd buyer who desires to buy and is able to pay in cash but is under no pressure to buy, and (b) a reasonably shrewd seller who desires to sell for cash but is under no pressure to sell. That is exactly the kind of question which American jurymen (who usually received their first degree in the Swapping Jackknives School) are well qualified to answer.

In the bulk of cases which arise, the rule of damages for a conversion is (a) the fair market value in cash of the property at the date of the conversion, plus (b) interest from that date to the date of the verdict. It is well within the powers of American jurymen to ascertain such damages with substantial accuracy.

We submit that the rule of " involuntary-purchase " damages is not worse, but better, than the rule of " compensatory " damages for two reasons: First, in the bulk of cases " involuntary-purchase " damages will accord more nearly to substantial justice than will the so-called " compensatory " damages which not in-

frequently prove to be "chiselled" damages, or, worse still, "sadly shrunken" damages. Second, a jury is better qualified to assess "involuntary-purchase" damages than it is to assess so-called "compensatory" damages. There is less guesswork about it.

Therefore, there is no justification for a court to say that a pledgor has an option to sue for a conversion or for a breach of contract when the wrongful act of a pledgee has been both a conversion and a breach of contract, and then to destroy the practical value of that option by holding that "nothing shall turn on the form of action," and that damages for the conversion shall be just the same as damages for the breach of contract. That amounts to giving an option to the pledgor only to the extent that he may *label* his action conversion or breach of contract as he pleases.

V. *A discussion of remedies for the wrong of conversion, with particular reference to Gordon v. Harper (p. 152), and modern procedural statutes. This discussion is also preliminary to the discussion of margin-customers cases in Chapters VIII to X inclusive. Our contention is that there is no more objection to the conception of a conversion by a pledgee of the pledgor's interest, than there is to the conception of a conversion by a pledgor of the pledgee's interest.*

For centuries trover and conversion were inseparable; *conversion* was the name of the *wrong* and *trover* was the name of the *remedy*. A plaintiff seeking to maintain trover against a defendant was required to show *two* things: (1) that the defendant had been guilty of that kind of tort called a conversion; and (2) that the plaintiff was qualified to sue him therefor. *Qualifying as a plaintiff in trover* was a large and difficult topic in the law.

Trespass was, and is, a possessory action *only*, as distinguished from a proprietary action. The general rule was, and is, that the plaintiff must show that he had actual or constructive possession at the time of the act complained of. Now, of course a plaintiff in trover could not be required to show that he had actual or constructive possession at the time of the act complained of, for the

very purpose of the action originally was to give relief to a person who had *lost* possession. But Plantagenet judges so stressed the importance of possession that it was natural — indeed, well-nigh inevitable — that they should lay down a general rule that in trover the plaintiff must show either that he was a possessor or that he was, so to speak, next door to a possessor by having the right to immediate possession at the time of the act complained of. There is no question but that that was the general rule.

We have already said that trover serves as a butler, ushering in litigants who wish to be heard on a question of title (p. 123). A majority of trover cases have been cases to try title. (We took 1890 reports from the court of last resort of twelve states in different parts of the country and found that about two thirds of the trover cases in those reports were cases to try title.) In handling such cases the general rule that a plaintiff in order to maintain trover must have possession or the right to immediate possession works admirably. We have no quarrel with this general rule; far from it. But it has been said that this rule is not merely a general rule, but that it is a sweeping, rigorous, inflexible, Medes-and-Persians rule, without any exception whatever.

We challenge that. It is characteristic of the common law that the judges, or at least the excellent judges, *develop* the law by laying down general rules, thereby obtaining reasonable certainty, but making sensible exceptions, thereby obtaining reasonable flexibility.

We urge that there ought to be an exception to the general rule, in case A bails property to B, C converts such property and A brings trover against C.

As a preliminary matter, let us state our conception of legal "ownership." We believe that it will conduce to accurate and clear legal thinking if the term "owner" is reserved for the person who has vested in him (and him alone) *all* the rights which the law permits with respect to the property in question. If A is in possession of a chattel, and no one has the right either then or at any future time to disturb that possession, he is owner (p. 137, note 36). But suppose that A bails the chattel to B. Popularly, A would still be called the owner. But the accurate way to express

the legal situation is, we submit, to say that A is a *part* owner, his interest being a non-possessory interest. We never use the word "bailor" except as it connotes just that. Conversely, B should be said to be a *part* owner, his interest being a possessory interest. We never use the term "bailee" except as it connotes just that.

Everyone is familiar with the idea that each of two tenants in common is a part owner. In that case, two part owners have *concurrent* interests. Our thought is that two part owners may have *successive* interests, one preceding and the other following. Compare a pair with a tandem.

The part owner having the possessory or present interest may or may not have the larger part interest. In cases of that species of bailment known as pledge, the part owner in possession usually has the larger part interest. But in a bailment for hire, the part owner in possession usually has the smaller part interest, — sometimes only a one per cent interest.

Now, should any *part* owner recover *whole* damages? That question is a question of *substantive* law. Make no mistake about that. The natural rule would seem to be that the amount of a plaintiff's damages should be commensurate with his interest, — if he were owner, whole damages; if he were only part owner, then part damages. If this were the law, there would never be a "spread" between the extent of the right and the extent of the recovery.

We have already emphasized that the Plantagenet judges worshipped the God of Possession before all other Gods. They achieved a conception of possession, and rights based upon possession, before they achieved a conception of ownership, or title (we use the two words as synonyms), and rights based upon ownership. There was a time when, if A bailed to B and C tortiously seized the chattel, B was the *only* person who could maintain an action against C. A was not even in second place; he was nowhere. As time went on this was *partially* remedied. B the bailee continued to be allowed to sue C, and because he was the *possessor* (even if he was only a very small part owner), he was allowed to recover *whole* damages; A was allowed to recover but only such damages as were commensurate with his part ownership.

There are two cases that should be placed side by side, — *The Winkfield*[40] and *Gordon v. Harper*.[41] In each case A is the bailor, B the bailee, and C the wrongdoer. In *The Winkfield,* B sued C and sought to recover whole damages. In *Gordon v. Harper,* A sued C and sought to recover whole damages.

The Winkfield was a case in admiralty. There had been a collision between two vessels caused by negligence of one, and as a result a large amount of mail which the other vessel was carrying went to the bottom of the sea. The Postmaster General sued as *bailee* for the whole value of what had been lost (presumably there was registered mail containing articles of substantial value). Counsel for the vessel which had been at fault did not see fit to raise the point that the company operating the vessel, rather than the Postmaster General, was the bailee. The court, therefore, addressed itself to this question: May a bailee recover the *full* amount of damage to the bailed property caused by the tort of a third person, even if the bailee is *not* responsible to the bailor to make good the loss?

On the facts of the case, the bailors were, in all probability, *delighted* to have the Postmaster General undertake the burden and expense of the litigation, and were well content that the Government should collect and account to them. The consent by the bailors to the bailee's having authority like the authority of an agent to sue and collect *might fairly be implied*. We regret that the court did not see fit to confine itself to the proper decision of the case before it. It did not. With a great flapping of historical and philosophical wings, it soared into the legal empyrean. In an elaborate dictum it laid down a *doctrine* which (if it is taken at its language value) is a doctrine (1) that the possession of *any* possessor — whether bailee, or finder, or tortious possessor — is as good as title against a wrongdoer, and therefore basis for a recovery of whole damages; and *also* (2) that the payment of such damages to the possessor bars the person having all rights other than possessory rights from any relief against anyone other than

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40 [1902] P. 42, 71 L. J., P. 21, 85 L. T. (N.S.) 668, 50 W. R. 246, 18 T. L. R. 178, 46 Sol. J. 163, 9 Asp. M. L. C. 259.

41 7 T. R. 9 (1796).

the possessor. From the rule in (1) that possession is as good as title *against* a wrongdoer, they deduce (2) that the wrongdoer is safe from the owner if he treats the possessor as owner. Possession becomes as good as title, for this purpose, not *against* the wrongdoer, but *for* the wrongdoer *against the owner*.

Of the three parties involved (bailor, bailee, wrongdoer) we should have supposed, in the unclouded light of reason, that the bailor was the person who should be *most* considered; but under the *doctrine* of *The Winkfield* he is the person who is *least* considered. The bailee is allowed to recover full damages. The court is also solicitous to see to it that the wrongdoer does not have to pay too much. But how about that forgotten man, the bailor? The court does not give due consideration to the very important facts (1) that most bailors prefer to control the litigation; (2) that the suit by B against C has *not* cleaned up the whole matter, that there must be an apportionment between A and B, and that B has an undue advantage in bargaining if he has the cash in his pocket; and (3) that many a bailee who can safely be trusted with a chattel will yield to temptation if he gets his hands on that quicksilver thing, — CASH.

We wish to make it plain that what troubles us is not the *result* reached in *The Winkfield* on the facts of that case, but the implications of the sweeping *doctrine* which the court saw fit to proclaim. We regret very much indeed to see the bailor the *least* considered of the three parties involved. Out of possession, out of mind. That is a Plantagenet thought which is not fit to survive.

We submit that it is a serious mistake to lump together, as the court did, (1) tortious possessors, and (2) finders, and (3) bailees. Existing possession must, of course, be respected. The Plantagenet judges rendered service in insisting upon that to a *partial* extent (for the favors they granted to disseisors was a serious subtraction from the service they might have rendered). It was the first indispensable step to escape from barbarism to a system based on law and order. Public policy required that the finder and even the tortious possessor should be allowed to recover whole damages from the wrongdoer — that he should not be allowed to

wriggle away by pleading *jus tertii,* even if exposing him to full damages left some problems which it was difficult to solve (and which, as a matter of fact, never have been solved). But the case of a bailee is an entirely different matter. The bailor is known. Therefore, unless the circumstances are such that the consent of the bailor to full recovery by the bailee may fairly be implied (as on such facts as in *The Winkfield* case itself), the court should require that notice be given to the bailor so that he may join in the action.

Time was, when there were no procedural facilities for that. Indeed, the root of the whole trouble in these cases has been that these questions were three-party questions, and that the common law had no machinery except a two-party machinery. The courts staggered along, trying to solve three-party problems with a two-party machinery. But today in the federal courts,[42] and in many states there is procedural machinery by which bailor, bailee and wrongdoer may all be made parties. In any jurisdiction which has such procedural facilities, the *doctrine* (do not confuse the result with the doctrine) of *The Winkfield* ought to be given a conspicuous place as a museum-piece.

In *Gordon v. Harper,* A bailed chattels to B for a term. The chattels were furniture in a house which had been leased furnished. The length of the term is not stated. Before the term had expired C tortiously seized, and A brought trover. Judgment was given for C, the wrongdoer, against A, the part owner (and probably the large part owner).

Now, put the *Winkfield* doctrine and *Gordon v. Harper* side by side. Assume that A has a chattel worth \$1,000, that he bails to B for a term for \$100, and that C tortiously seizes. B, the *small* part owner, may obtain judgment for \$1,000 against C, becoming accountable to A for the value of A's \$900 interest. But A, the *large* part owner, may not obtain judgment for \$1,000 against C, becoming accountable to B for the value of B's \$100 interest.

[42] See 20(e) in the Rules of Procedure for the District Courts of the United States.

The tail can wag the dog, but the dog cannot wag the tail. This seems to us to be ridiculous.

Let us now look at the reasons offered by the judges in *Gordon v. Harper* to justify such a decision.

In *Ward v. Macauley*,[43] A had leased a house with furniture to B. C unlawfully seized. A brought trespass. At the trial Lord Kenyon thought that trespass would not lie, and that the plaintiff should have brought trover. When the case came before the court *in banc*, this ruling was affirmed. Lord Kenyon said: " The distinction between the actions of trespass and trover is well settled . . . his remedy was by an action of trover."

Five years later he presided in *Gordon v. Harper*. He then took back what he had said about trover in *Ward v. Macauley*. No, not even trover would lie. For that might prejudice the creditors of the bailee.

Certainly that would not be a persuasive objection today. If A were permitted to collect whole damages he would be obliged to account to B for B's part, and today there would be no difficulty about allowing the creditors of B to reach and apply toward satisfaction of their claims this asset belonging to B. Lord Kenyon overlooked the fact that B, the bailee, was allowed to recover whole damages and that by a parity of reasoning this was indefensible because it might prejudice the bailor's creditors.

Ashhurst, J., said that he had " always understood the rule of law to be that in order to maintain trover the plaintiff must have a right of property in the thing, and a right of possession, and that unless both these rights concur the action will not lie." Then he too mentioned the possible harm to creditors of B if A were allowed to recover whole damages.

Grose, J., said: " The only question is whether trover will lie where the plaintiff had neither the actual possession of the goods taken at the time, nor the right of possession. *The common form of pleading in such an action is decisive against him;* for he declares that *being possessed, &c.* he lost the goods; he is therefore

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[43] 4 T. R. 489 (1791).

bound to shew either an actual or virtual possession." (Italics supplied.)

Lawrence, J., said: " The observation which my brother Grose has made upon the form of the action of trover is very material; the plaintiff therein states that he was possessed of the goods mentioned, and being so possessed he casually lost them, and that they came to the hands and possession of the defendant by finding."

Nota bene these opinions by Grose and Lawrence, JJ. It is true that originally a plaintiff in trover was required to allege (1) that at some time past he was in possession of the chattel in question, (2) that he lost it, and (3) that defendant found it. But (1) is obviously only setting the stage for (2) and (3). In course of time the action of trover was developed, and mightily developed, and allegations (2) and (3) quickly became nontraversable. Yet now the court in *Gordon v. Harper* is placing all the emphasis on the *stage-setting* allegation (1). (2) and (3) are not material, but (1) is lifted out of the dust bin and becomes all controlling.

But assume that (1) still remains in full vigor, although (2) and (3) have fallen into innocuous desuetude. What does that prove? It proves that the plaintiff should win. For he *had* proved that " at some time past he was in possession of the chattel in question."

Grose, J., says, that he alleges that " being possessed, &c. he lost the goods; he is therefore bound to shew either an actual or virtual possession." But surely this allegation of " being possessed " referred to " being possessed " *at a time prior to the loss*. It is only by the alchemy of confusion that there can be extracted from this a requirement that plaintiff must allege that he was in actual possession or had the right to immediate possession *at the time of the act complained of*.

The result in *Gordon v. Harper* seems to us not sensible, and the reasoning demonstrably weak. Moreover, it was out of harmony with the authorities. The Abridgements stated that where A is bailor, B bailee, and C a trespasser, either A or B might have trespass (and, a fortiori, trover), a recovery by the first barring the other. Thus in 2 Rolle Abr. (1668) 569 (P) 5, we read: " Si bailee del beins port trespas, & bailor auter trespas, cestuy que

premierment recover oustera l'auter d'action. 48 E. 3, 21, 20 H. 7, 5b." [44] And even Blackstone said that the bailee, *as well as the bailor* (italics supplied) might maintain an action against such as injure or take away the chattels.[45]

Baron Parke, one of the strongest English common law judges of the nineteenth century, with an exact mind, rather on the severe side, and with a relish for the strict rules of pleading, said of *Gordon v. Harper:* " That case might, with great propriety, have been differently decided in the first instance." [46]

There is another English case worth mentioning. In *Mears v. London &c. Co.*[47] the court held that a bailor, if he brought simple case, instead of trover (our p. 110), might recover whole damages for a permanent injury. The court was not troubled by allowing the part owner to recover whole damages, even though he did not have the right to immediate possession.

We turn to this country. There is the impressive authority of Story's considered opinion against *Gordon v. Harper.* Story (1779–1845) became an Associate Justice of the Supreme Court of the United States at the age of thirty-two, and served for thirty-four years. He made a great team of two with Marshall. Legend has it that Marshall concluded a consultation of the members of the court by saying: " Such is the law; Brother Story will fill in the authorities." Story was also a member of the Harvard Law Faculty from 1829 to 1845. In 1831 he published, as part of the first fruits of his labors as a member of such Faculty, a treatise on " Bailments " which has been received with profound respect not only by American judges but also by English judges, including that hardheaded, shrewd judge, Mr. Justice Blackburn.

In that treatise, after stating that a bailee might, by reason of his special property, maintain an action against a third person

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44 See also Holdsworth (1937 edition) Vol. III, p. 348.

45 Comm. Book II, p. 453.

46 *Manders v. Williams,* 4 Exch. 339, 343 (1849). His opinion is all the more remarkable because of the ultra-conservatism shown by him in 1844 in *Franklin v. Neale* (see our p. 42).

47 11 C. B. (N.S.) 850, 31 L. J., C. P. 220, 6 L. T. (N.S.) 190 (1862). See also *Tancred v. Allgood,* 4 H. & N. 438, 28 L. J., Ex. 362 (1859).

for any tortious dispossession or injury, Story said: " But since, in such case, the owner has also a *general* property, unless he has, by virtue of his agreement, parted with it for a term, *he also may maintain a like suit against the stranger.* But in such case a recovery by either, it seems, bars, or at least may bar, the action of the other." [48] (Italics supplied.)

He was familiar with *Gordon v. Harper* (it is mentioned in the notes to the first edition). But, far from supporting *Gordon v. Harper,* Story reached the opposite conclusion. His doctrine is that *either* the bailee or the bailor may sue, and that the suit of the bailor is " a like suit " with the suit by the bailee.

There is no doubt but that this was Story's considered opinion. For in another section where he was considering, not a contract of hire, as in § 394, but a pledge, he said: " As the general property of goods pawned remains in the pawner, and the pawnee has a special property only, the latter (as we have seen) may not only maintain an action for an injury done to the thing by a stranger, but the former may *also* maintain an action against a stranger for any injury done to it, *or any conversion of it.* . . . But, where there is an injury or *conversion* by a stranger, for which an action lies, *both* by the pawner and pawnee, it is said, that a recovery by either ousts the other of his right to recover, for there cannot be a double satisfaction." [49] (Italics supplied.)

Ames v. Palmer [50] was an action of *trover* for a cask and twenty gallons of rum, taken from on board a vessel. Defendant contended that plaintiff was bound to show that the freight on the property from Boston, due to the owners of the vessel which brought it, had been paid and the lien discharged, and the trial judge so ruled. The court held that this was error. It said that the plaintiff in an action of trover cannot recover without proof of property in himself and the right of immediate possession, and nevertheless concluded that the lien of a common carrier did not deprive the owner of the goods of his right to immediate possession as against a tortfeasor.

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48 Bailments, first edition, § 394.

49 Bailments, § 352.

50 42 Me. 197, 66 Am. Dec. 271 (1856).

JOSEPH STORY

Justice of the Supreme Court of the United States
Professor of Law at Harvard

We submit that the court, while paying lip-service to the doctrine of *Gordon v. Harper,* decided contrary to the way in which it must have decided the case, *if* it really believed in *Gordon v. Harper.* For even a mere lien (pp. 12, 13) is an outstanding interest respecting the *res* and the owner is *not* entitled to the possession of that *res* until he pays the charges secured by the lien.

Why should the requirements to qualify as a plaintiff in trover be more rigid, inflexible than the requirements to qualify as a plaintiff in trespass *d.b.a.?* No doubt, the general rule in trespass was, and is, that the plaintiff must prove that he was in actual or constructive possession at the time of the act complained of. But even the medieval judges did not hesitate to make exceptions which seemed to them sensible. They would listen. Going through the authorities we found seven exceptions for each of which there was at least some authority at some time. But enough is as good as a feast, and we will mention only four:

1. If possession was taken lawfully, but without the consent of the former possessor (say, by an officer of the law acting in behalf of some creditor), and later there was tortious conduct by the possessor, such possessor might be sued in trespass as a trespasser *ab initio* for his *entry,* although that entry was lawful when made.[51]

2. Executors and administrators could sue for an asportation of the goods of the deceased which occurred between his death and the qualification of the executor or administrator, even if such executor or administrator was not in actual possession at the time.[52]

3. If A in, say, London sold or gave goods in, say, York to B, under some circumstances B could have trespass against a wrongdoer who took the goods from an X who had not agreed to hold them for B.[53]

4. If the property was bailed by A to B at will, and C tortiously took, A could maintain trespass against C. In *Ward v. Macauley*

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51 *The Six Carpenters Case,* 8 Co. 146, 146b (1610). See Holdsworth, A History of the Law of England (1937 edition) Vol. VII, p. 498.

52 Holdsworth, Vol. VII, p. 422.

53 *Ibid.,* Vol. III, p. 348.

(p. 153) the scope of this exception in bailment cases was *cut down* to cases where the bailment was not for a term. The medieval law had been *less* rigid, — there was a time when the courts allowed a bailor to maintain trespass against a wrongdoer who took from a bailee, and did not distinguish between some kinds of bailments and other kinds of bailments.

Put this medieval law as to *trespass* side by side with *Gordon v. Harper,* an authority on the law of *trover.* If it was proper for the courts to make so many exceptions to the general rule as to what was necessary to qualify as a plaintiff in an action of trespass, what basis is there for saying that it is improper to make even a single sensible exception as to what is necessary to qualify as a plaintiff in an action of trover? Trespass was the older action. Trover was an action on the case, and was supposed to be adaptable " to the case." We should naturally expect less, not more, rigidity.

Moreover, so far as *defendants* were concerned, trover did not lie forever cramped in its first mould. Far from it. There came to be *extraordinary* flexibility as to the defendants who, so to speak, could qualify. Then what basis is there for saying that there is a Medes-and-Persians rule regulating the qualifying of a plaintiff?

Review the authorities. According to the Abridgements, the bailor had as great rights as the bailee (p. 154). Blackstone was to the same effect (p. 155). Lord Kenyon said, only five years before *Gordon v. Harper,* that trover *would* lie. The reasoning of the judges in *Gordon v. Harper* is demonstrably weak (pp. 153–154). Even Baron Parke, of exact, stiff mind, doubted the propriety of the decision (p. 155). In the *Mears* case, an English court had no difficulty with allowing a part owner out of possession to recover whole damages (p. 155). In *Ames v. Palmer,* an American court, while paying lip-service to *Gordon v. Harper,* decided the case exactly opposite to the way in which it should have been decided if the court really believed in *Gordon v. Harper* (pp. 156–157).

And, above all, there is the impressive fact that Story, that very learned, serene, reliable, wise judge, head and shoulders

above the tallest of the four judges who decided *Gordon v. Harper*, stated the law to be exactly the contrary to what was there decided.

Which lead should American courts follow? The lead of ill-reasoned *Gordon v. Harper*, a case *not* a part of the common law in 1776 (p. 60), or the lead of Story?

During the many years that the author has been a member of the Harvard Law Faculty he has confined his legal thinking almost exclusively to American common law, equity and statutes, with their English backgrounds (although since Canada became in substance a nation he has sat up and taken notice). But, on holiday, he has sometimes taken a busman's holiday, roaming about in Roman Law. Now, perhaps there was a time far, far back when Roman Law laid as great stress upon possession as did the Plantagenet judges, but the author thinks that such a statement could not properly be made with respect to the *developed* Roman Law, about which Savigny wrote in his treatise on Possession. In the *developed* Roman Law, possession still had a place, and a very important place, but it was definitely the second place. Ownership (using that term in the popular sense, and as equivalent to Story's "general property," and as equivalent to the author's "rights of a part owner who is out of possession") had the first place; and, if a clash threatened between ownership and possession, possession was obliged to yield precedence.

The author knows so little about Roman Law that he warns the reader against accepting these statements as accurate. He is only interested in the worth of the idea which he picked up while roaming about. He submits that this conception of the relative importance of "ownership" and possession is much more sensible, much more properly balanced, much better adapted to the needs of modern society, than the conception which dominated the minds of the Plantagenet judges.

We have no disposition to ridicule the Plantagenet judges. We have great respect for them. In intellectual acumen and general ability, we believe — although of course we cannot prove it — that if you were to take all the judges who served in the Plantag-

enet period (1154–1485), and ascertain the average intellectual ability as X, and then take all the judges of the English and American courts (excluding inferior courts) at the present time, and ascertain the average intellectual ability as Y, X would be found to be not less than Y. Many of the rules that they laid down were probably excellent rules for the conditions of their time. What we are urging is that the law is a growth; that *all* that was good in Plantagenet days is not good "for all time," Dean Ames to the contrary notwithstanding (p. 50); that the law builds on its dead selves; that the time came long ago, and certainly is now come, to put away some (not all) Plantagenet conceptions; that "ownership" (as that term is popularly used) should be given first place and that to possession should be given an important, but second, place.

The persons who arouse feelings in the author which he must admit are not wholly free from contempt are those who cling to old rules with which they have long been familiar and, reason or no reason, cling on and on with almost Chinese worship for the past, and verily *resent* attempts to show that such rules no longer serve a useful purpose. They act as though they were threatened with a deprivation of mental property without due process of law. But we realize that one ought to be gentle with such persons. After all, self-preservation *is* the first law.

So far we have been assuming that we were in a jurisdiction where the action of trover is still used. But, in fact, there are few such jurisdictions left. For some reason or reasons which we do not fathom, the law turned more rigid and technical between 1750 and 1850 than it had previously been. Something not wholly different from *rigor mortis* set in. So many nice distinctions were made about forms of action, so many opportunities were given for "smart" lawyers to win, that laymen revolted, and in jurisdiction after jurisdiction, beginning around 1850, statutes were passed with the hope of liberalizing procedure. Few things are more dangerous than to make sweeping statements about statutes where many states have varying statutes on the matter in question. The only statements that we think it is safe to make

are (1) that pretty surely most, if not all, of these statutes were passed by the respective legislatures in an earnest desire to "remove technicalities from the path of justice"; and (2) that most, if not all, of these statutes are easily susceptible of a construction which will, at least in large part, carry out this general desire of the legislature.

If a court is prepared as a question of substantive law to allow a part owner out of possession to collect whole damages, *and* there is such a statute, so construed, no obstacle blocks the way to the sensible result.

It is disheartening (no politer word is appropriate) to note that in some states the reception which the courts have given to such statutes has been chilling. Massachusetts is, we very much regret to say, one of those states.

In the *Raymond-Syndicate* case,[54] A had bailed to B for ninety days, C seized before the ninety days had expired, and A brought "an action in tort." At the trial, A obtained judgment for the value of the property. C alleged exceptions, and claimed that A could not maintain the action since he had neither possession nor the right to immediate possession at the time of the seizure. And the court sustained the exceptions.

It said: "The declaration follows a statutory form first given in St. 1851, c. 233. . . . None of these statutes abolished the action of trover. Each of them enacted that there should be only three divisions of personal actions, one of which divisions, actions of tort, has always included the action of trover by that name. . . . Under the old practice the owner of chattels could not maintain trover for their conversion unless when the acts complained of were done he had possession or the right to immediate possession. The owner's remedy for damages done when he had neither possession nor the right to immediate possession was an action on the case. . . . After the adoption of the practice acts it was held that they made no change in the rules of evidence applicable to the causes of action comprehended under the designation of actions of tort, and that it was still necessary under the statutory form given for trover that the evidence should be such as would have

[54] 177 Mass. 562, 59 N. E. 446 (1901); our p. 161.

proved a conversion in an action of trover at common law. . . . It is settled that to maintain tort under a declaration like the present one the plaintiff must show possession or the right to immediate possession." The court also referred to previous decisions which gave support to its decision.

This amounted, we submit, to a declaration that the legislature had intended to make no change except in name, — that an action of trover should now be *called* an "action for tort." The more the thing changes, the more it is the same thing. According to the Supreme Judicial Court of Massachusetts, the Massachusetts Legislature had labored and had brought forth a mouse.

This was a narrow construction, possibly justifiable, but certainly narrow. It drained from the statute all liberalizing tendencies. *Labels* only were changed. This is an example of what seems to us may fairly be characterized as destructive conservatism.

The *Raymond-Syndicate* case was a straight *Gordon v. Harper* case. So far as we know there has been no subsequent case in Massachusetts which was a straight *Gordon v. Harper* case.[55]

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[55] In *United Shoe Machinery Co. v. Holt,* 185 Mass. 97, 69 N. E. 1056 (1904), the court cited the *Raymond-Syndicate* case, but distinguished it. In *Hodgkins v. Bowser,* 195 Mass. 141, 80 N. E. 796 (1907), the court cited the *Raymond-Syndicate* case, but distinguished it.

We have heard it contended that *Lincoln Park Garage v. Devonshire Corp.,* 277 Mass. 303, 178 N. E. 739 (1931) was on all fours with the *Raymond-Syndicate* case. But the facts were very different. A was a conditional vendor of automobile No. 1 to B. B proposed to substitute automobile No. 2. B sold automobile No. 2 to X, and C seized it pursuant to a lawful claim under X. A brought tort against C. It is true that the court held that the action would not lie. But why? Because the court ruled that the *intended* substitution had never been *effected.* Therefore A had no rights in automobile No. 2. Note, moreover, that C had not seized from B, — C was a remote assignee of B. B had no ground for complaint against C. The case does not present the question whether if B, the small part owner may sue, nevertheless A, the large part owner may not sue. The *Gordon v. Harper* question was not even before the court.

In *Nash v. Lang,* 268 Mass. 407, 414, 167 N. E. 762, 765 (1929), Rugg, C.J., said: "The delivery of a chattel in bailment, apart from specific stipulation, confers upon the bailee the right to use and enjoy possession free from control by the bailor, subject to the obligation to do so with care, with due regard to its nature and characteristics and its preservation in safety, and to return it in good order barring unavoidable casualties at the expiration of the bailment. The general title

As to what the law will become in Massachusetts we make no prophecy. But we incline to believe that the court will sustain a finding for a plaintiff if the evidence warrants a verdict for him in any form of declaring; and, moreover, that the court is not definitely committed to a doctrine that a bailor may never recover whole damages against a wrongdoer in any case in which in the old days an action of trover would have been on the facts the appropriate form of action (even if counsel for the defendant relies upon the form of the declaration as a defense). Compare the reasoning in *Weiner v. D. A. Schulte, Inc.*[56]

In any event, we submit that in the *Raymond-Syndicate* case the Supreme Judicial Court of Massachusetts has *not* given a lead which should be followed by other courts, especially if the statute in such other state is in a different form from that of the Massachusetts statute. Almost all other statutes are in a different form.

Furthermore, all that we have said above about modern procedural facilities for handling three-party problems by a new three-party machinery is here applicable. Unless the assent of B, the bailee, to the recovery of whole damages by A may on the facts be fairly implied, the court should require that notice be given to B of the pending proceeding (cf. p. 152). That will lead to a just solution of the problem.

This brings us to the really important point so far as this treatise is concerned. In *Whitman v. Boston Terminal Refrigerating Co.*,[57] A pledged to B. A defaulted. B made a liquidating sale, but the sale was not fair, — B sold to a subsidiary X at a price less than the fair market value (p. 146). A's successor brought tort against B. He did not seek whole damages, but only the fair market value, *less* the debt. *The defendant urged that the action*

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remains in the bailor; the bailee has a special interest for the purposes of the bailment. The bailor may maintain an action against a third person *for permanent injury to the chattel or for its conversion* or for its replevin." (Italics supplied.)

See also *Marder v. Moose Hill Tonic Co.* 286 Mass. 126, 131, 189 N. E. 581 (1934), and *Massachusetts Lubricant Corp. v. Socony Vacuum Co., Inc.*, Mass. Adv. Sh. (1940) 323, 25 N. E.(2d) 719.

[56] 275 Mass. 379, 384–5; 176 N. E. 114 (1931).

[57] 233 Mass. 386, 391, 124 N. E. 43 (1919).

could not be maintained, since A had neither the possession nor the right to immediate possession at the time of the act complained of. The court, nevertheless, allowed the action to be maintained, saying: " It is argued that, until the debt is paid off, the pledgee has the whole of the present interest, and that a sale does not entitle the pledgor to bring an action for conversion which assumes the right to immediate possession. But a tender is not necessary as a condition precedent where the pledgee, if he acts wrongfully, has put it out of his power to return the property. The pledgor under such conditions may recover the fair market value of the merchandise less the amount of the debt for which the goods were pledged."

This is the main point which we wish to establish, and we shall return to this case again when we discuss *Wood v. Fisk* (pp. 225–253).

Grasp the distinction between an A, C case, and an A, B case. The A, C case (A bails to B, and C converts) *does* raise the question whether a part owner may recover whole damages. That is a question of substantive law, — it is not merely a procedural question. But the A, B case does *not* raise this question of substantive law. A is not seeking whole damages. He is a part owner seeking part damages, commensurate to his interest. The Massachusetts decision in the *Boston Terminal Refrigerating* case is a square authority that, even under *its* procedural statutes, there is no difficulty which blocks a pledgor from suing his pledgee for a *conversion of the pledgor's interest.* In such a case tort for conversion *does* lie, even if the plaintiff had neither possession nor the right to immediate possession at the conclusion of the act complained of. The court does not shy, like a skittish horse (as some jurists do) at the mention of the word " conversion " by a plaintiff who did not have the right of immediate possession at the conclusion of the act complained of.

Grasp the fact that in bailor-bailee cases (internal struggles) there may be a conversion of the *bailor's interest* by the bailee, just as there may be a conversion of the *bailee's interest* by the bailor (p. 210, note 34). The rest is routine.

The reason why we have taken so much space over *Gordon v. Harper* is that we fear infection from it. There is danger that a

court may hold (1) that A must have the possession or the right to immediate possession in an A, *C* case; and then *leap* ("leap" is the *mot juste*) to the conclusion (2) that A must have the possession or the right to immediate possession in an A, *B* case. We want to draw the decayed tooth lest it send poison into the system.

A, C cases are not very numerous and are, as a practical matter, of small importance. But A, B cases are numerous and are, as a practical matter, of very large importance. The main thing that we are striving for is that there shall be the right decision in the A, B cases. *Wood v. Fisk delendum est.*

The author has in recent years heard conversion and pledge spoken of as old-fashioned, outmoded topics to which but little time should be devoted in the training of men who expect to practise law. Such a conception amazes him. He has for forty years been wrestling with legal problems, principally problems in the law of corporations and the law of property, and, with the sole exception of quasi-corporation problems, he has wrestled with no problems, not excluding some real property problems of great legendary difficulty, which have seemed to him more baffling, more difficult to probe to rock bottom foundations than some of the problems in conversion.

The roots of the law on this topic go far, far down into common law soil. Some of the rules come to us out of a remote past unsupported by *expressed* reasons, and it is impossible to make more than a pretty good guess as to why they were adopted. At times, the author has been reminded of the Ten Commandments, — Moses gave no reasons, but they are good commandments, nevertheless.

We cannot comprehend how any person can be a reliable guide for any business unit, and especially for a bank, trust company, or other financial institution, unless he is *well* grounded in the law of conversion. It *is* a difficult and rather a technical topic, and should frankly be recognized as such. He who relies on his native common sense is almost sure, at some one or more times in his professional career, to shed tears, and it may well be that he will drain his client's purse.

Chapter VI

TORTIOUS WITHHOLDINGS

IN 1831, Story wrote: "The pawnee makes himself responsible for all losses and accidents, whenever he has done any act inconsistent with his duty, or has refused to perform his duty. If, therefore, the pawner makes a tender of the amount of the debt, for which the pawn is given, and the pawnee refuses to receive it, or to redeliver the pledge, the special property, which he has in the pledge, *is determined* (italics supplied), and he is henceforth treated as a wrong-doer and the pawn is at his sole risk." [1]

He also said: "If, however, the transaction is not a [mortgage], but a mere pledge, as the pledger has never parted with the general title, he may, at law, redeem, notwithstanding he has not strictly complied with the condition of the contract. If a clause is inserted in the original contract, providing, that if the terms of the contract are not strictly fulfilled at the time, and in the mode prescribed, the pledge shall be irredeemable, it will not be of any avail. For the common law deems such a stipulation unconscionable and void upon the ground of public policy, as tending to the oppression of debtors. . . . It is clear, by the common law, that in cases of pledge, if a stipulated time is fixed for the payment of the debt, and the debt is not paid at the time, the absolute property does not pass to the pawnee. This doctrine is, at least, as old as the time of Glanville. If the pawnee does not choose to exercise his acknowledged right to sell [see our p. 188], he still retains the property as a pledge, and upon a tender of the debt he may, at any time, be compelled to restore it; for prescription, or the statute of limitations, does not run against it. However after a long lapse of time, if no claim for a redemption is made, the right will be deemed to be extinguished; and the property will be held to belong absolutely to the pawnee." [2]

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[1] Bailments § 341.

[2] Ibid., §§ 345, 346.

In a word, A, the debtor-pledgor, may make a belated tender; and if, when tender is made at or after maturity of the full amount due the creditor-pledgee refuses to accept it and withholds the pledge, the pledgee's right *in rem* is terminated, forfeited. The creditor-pledgee had two rights, — (1) a right *in personam,* the debt, and (2) a right *in rem,* the security which buttressed the right *in personam* (p. 17). By his conversion he has forfeited the buttressing right *in rem.* The right *in personam* is unaffected, — he is still a creditor. But by his tortious withholding — and here is the gist of the matter — the creditor has changed himself from a *secured* creditor into an *unsecured* creditor.

Is that still the law? We will speak of three cases decided since Story's time, — *Cass v. Higenbotam, First National Bank of Seattle v. Gidden,* and *McCalla v. Clark.*

Cass v. Higenbotam [3]

The action was brought upon a promissory note for $350. The note was admitted by the answer, but it was alleged, by way of defense, that the amount of the note with interest and costs had been tendered by A, the pledgor, to B, the pledgee, after suit brought; *and,* by way of counterclaim, that certain diamonds had been pledged as security, and that after suit brought A had tendered to B the full amount due on the note with interest and costs and demanded a return of the diamonds; that B refused to accept the tender and return the diamonds, but had converted them to his own use, to A's damage $1,000, for which judgment was demanded.

B replied, admitting the making of the pledge, but setting up that before the offer of payment and demand of the return of the diamonds, an action had been commenced against him by C, the wife of A, for a portion of the diamonds, claiming them as her property; that A was notified of that action and became a party thereto; and that B, at the time of the alleged tender, offered to return to A the diamonds *not* claimed by C upon payment of the note, but that A refused to accept such portion and to make payment.

[3] 100 N. Y. 248, 3 N. E. 189 (1885).

At the trial the facts set forth in the answer and reply were proved. It was also proved that the action brought by C was still pending undetermined. The court directed a verdict in favor of B, the creditor-pledgee. The judgment obtained in the trial court was affirmed by the General Term of the Supreme Court.[4] But the Court of Appeals reversed this judgment and granted a new trial with costs to abide the event. One judge dissented from this judgment of reversal.

Counsel for B argued that the only available tender that could be made after suit brought was prescribed by a section of the Code of Civil Procedure which required that, in case of such a tender, it should be made with costs to the time of tender, and that, if not accepted, it *must be paid into court*. He also argued that as matter of law the alleged tender, being conditional, was not a valid tender *for any purpose*.

The court said that " the principal question " was as to the validity of the tender. " Being a conditional tender, and depending upon the return of the property, which was demanded, there would seem to be no obligation on the part of the defendant to pay the money into court, as in that event the plaintiff would have been entitled to the money absolutely. He had no right to it without the return of the goods and, as that was refused, no reason exists why the defendant should pay the money into court. The plaintiff was fully protected without the defendant's so doing, as he retained the property in his possession. The obligations of the pledgor and pledgee are mutual, concurrent and reciprocal. Where either party performs, he is entitled to performance by the other as a condition of his own performance. The refusal of either, where performance is tendered, furnishes ground for an action. Tender is not required in such a case by a deposit in court for the reason that a payment into court is unconditional, and from that time the money becomes the property of the plaintiff absolutely. . . . A tender of performance may always be restricted by such conditions as by the terms of the contract are conditions precedent, or simultaneous, or proper to be performed by the party to whom tender was made." [5]

[4] 27 Hun 406 (1882).

[5] At page 253 of the official report.

On the facts, had B converted the diamonds? Unless the refusal to return was justifiable or excusable, there was clearly a conversion, and A had a right to bring an action against B for the recovery of the value of the diamonds, *or* to interpose a counterclaim for such value in an action brought by B. The action brought by a third party, C, did not justify B's refusal. If there were conflicting claims, B " had a complete remedy by bringing an action in the nature of a bill of interpleader, making the claimants parties thereto, and in that form of action it could be determined who was the true owner of the property. In that way he could have avoided all risk or hazard."

The court said that the action brought by C was no protection to A. C had a right to discontinue that action at any time. Moreover, even if C lost, A could not have any relief in that action, — he would have to bring an action against B to recover the diamonds. That might result in a long delay before A got his own. The pendency of C's action was clearly no adequate reply to A's counterclaim. " By a bill of interpleader the whole matter could have been disposed of in a *single* action." (Italics supplied.)

Comment:

1. A made to B an enforceable promise to pay money. He did not keep his promise. There was no " if " in A's promise. His promise was not a promise to pay money *if* (1) B demanded it, and (2) B offered to hand back the security at the same time that he received the money. A's duty to pay was absolute, not conditional. If he did not pay as agreed he was in default. No *tu quoque* gave him a *defense*. A's counsel set up the conditional tender as a defense, but it was no defense.

But although A had no *defense*, A did have a good *counterclaim* against B. A gave B security. B was obligated to hand back the security *if* A made B a proper tender. The law permits the debtor to make tender even after suit brought, if he adds interest and costs. Therefore, a belated tender may be a proper tender, and A in this case had made a proper tender.

This brings us to the main point. Let there be a bright line

drawn between what is necessary for a *defense* to a *claim,* and what is adequate as a *basis* for a *counterclaim.* The conditional tender was *not* good as a defense, and, although counsel for A had in his answer given the tender as a defense, apparently he did not (and wisely did not) press this in argument. But the conditional tender, though not good as a defense, *was* good as a basis for a counterclaim for the following reason:

B had only a *conditional* duty to A, — to surrender the security *if* A tendered. *Here* is where *reciprocity* comes in. If B can refuse to surrender the security if A does not pay, A, reciprocally, can make (not as in defense but as a basis for a counterclaim) a *conditional* tender to pay, — a tender to pay B *if* B, as a part of the same transaction, returns the security. Therefore, if such conditional tender is refused, B has tortiously withheld (p. 118), and is a converter.

At the due date of the note A was the *only* person who was wrong. But later B put himself *also* in the wrong. It then became criss for cross. A acquired a cause of action against B, which A might have enforced in an independent action, or which A might use, under the New York procedural statutes, in B's action against A, even (1) if B's claim against A was based on a breach of contract and A's claim against B was based upon that kind of tort which is called a conversion, and even (2) though A's counterclaim was for a larger amount than B's claim so that, if A should prove to be successful, A would be entitled to affirmative relief.

Note that the court had said (p. 253 of official report; our p. 168): "The obligations of the pledgor and pledgee are mutual, concurrent and reciprocal. Where either party performs, he is entitled to performance by the other as a condition of his own performance." Unless you watch your step, you will slip here. This language is applicable *not* to A's *defense* to B's claim, but to A's *counterclaim* against B.

A's position is, we submit, unanswerable in any jurisdiction which has procedural statutes as to counterclaims with provisions substantially similar to the excellent New York provisions.

Before we leave this first point we suggest that it is highly desirable *never* to use " defense " as a word with such a broad

scope that it will include "counterclaim" as one kind of defense. We fully realize that "defense" is not infrequently used as a generic term and that "counterclaim" is used as a specific term, — *one* kind of defense. And "defense" is often used popularly as a generic term, as when one says that the best defense is an offense. But the author's thoughts on these rather puzzling matters never became clear until in his thinking he came to *contrast* defense with counterclaim, instead of lumping them together. He believes it may help others to clear thinking on these matters if they keep bright the line between "defense" on the one hand, and "counterclaim" on the other hand. The word "defense" will hereafter in this book be used *only* in the narrow, specific sense, — as something which does not include "counterclaim," but is, on the contrary, *contrasted* with it. Contrast a *shield* with a *tu quoque sword*. A defense is a shield; a counterclaim is a *tu quoque* sword.

2. Did A have a good counterclaim against B? (1) The *conditional* tender was good, therefore there had been a proper tender and demand; (2) B conceded that he had had possession of the diamonds, — that he had had the ability to surrender if he were so minded; and (3) B had absolutely refused to surrender. (He had not made a *qualified* refusal, as preliminary to an interpleader. See our p. 125).

That was enough to raise a prima facie case of conversion, as the judges in *Isaack v. Clark* (p. 118) would have expressed it. But that prima facie case might be rebutted by showing that the refusal was justifiable or excusable. The pendency of the action brought by C was neither a justification nor an excuse. It was *not,* for the reasons stated by the court, "just as good" as an interpleader. It was on this "just as good" point, and on this point alone, that the Court of Appeals and the General Term differed.

Therefore, B was a converter, and A did have a good counterclaim against B. The case is sent back for a new trial. Note (to return for a moment to Comment 1) that, if A's promise to pay money to B had been not absolute but conditioned on demand by B and offer to hand back the security, B would, on the facts of the case, have had no cause of action against A, and the proper dis-

position of the case would therefore have been: "Judgment for A with costs."

But that is *not* the disposition which the court makes of it. It sends back claim *and* counterclaim, criss and cross, to be balanced against each other. The amount due B on the claim was plain, — $350 and interest. The amount due A on the counterclaim was to be ascertained by a jury (or other trier of the fact). A claimed that the diamonds were worth $1,000. Was that their fair market value (p. 146) at the date of the conversion? The jury might think that that was a grossly exaggerated appraisal, and might find that the diamonds were worth less than the debt. In that case, B will get judgment for the deficiency with interest and costs. But the jury might think that the diamonds were worth more than the debt. In that case, A will get judgment for the excess with interest and costs. Costs are to abide the event.

3. The court said (p. 252) that, upon B's refusal to accept the tender and hand back the diamonds, B became liable to A "in an action of trover or assumpsit." B as pledgee has certain duties toward A, the pledgor. One of these duties is to return the security when a proper tender is made. The law imposes that duty; it implies a promise by B to A that he will so do (if there be no such promise in fact). Now, if B violates his duty, that is a breach of the implied promise, and therefore assumpsit lies. But a tortious withholding is a conversion. Therefore, B's conduct was *both* a breach of contract and a tort. A elected to sue in tort. It never occurred to the court or counsel to suggest that A's *only* remedy was in contract. *Nota bene,* and remember this when we come to the assault upon *Wood v. Fisk* (pp. 225–253), that citadel of mischief, the investment of which is gradually tightening. *Wood v. Fisk delendum est.*

4. The court made three dicta about replevin. On p. 252 it said that, upon B's refusal, A might bring (a) replevin, (b) trover, or (c) assumpsit, — he might seek the *res* in replevin, or money in trover or assumpsit. Again, at pp. 254–5 it said that the plaintiff could not retain the property after the tender and that A could recover *it* or its value.

But, after having said, on p. 252, that A might bring replevin,

trover or assumpsit, it went on to say: "If the action was for a recovery of the goods, then the court, no doubt, would have the right to make provision that the debt be paid before the property was delivered."

What does this mean? Replevin is a possessory action. Normally it is *begun* by an officer of the law seizing the property in behalf of a plaintiff who has the right to immediate possession. If there were an outstanding, unforfeited pledge interest, A would not have the right to immediate possession, and replevin would *not* lie. Did the court mean that, even though replevin lay, nevertheless the court would order the plaintiff who by replevin has secured the *res* to return the *res* unless he paid his debt? We know of no authority for any such doctrine.[6] Such a doctrine does not make sense if the pledge interest has been forfeited and B has been changed from a secured creditor into an unsecured creditor.

There are, it should be recognized, three dicta as to replevin. According to two of them, the pledgee's right *in rem* was terminated by the conversion. According to one of them, *apparently* (we do not feel sure that we have fathomed what was in the mind of the court) it was not. We hope and believe that the inconsistent minority dictum will not come back to give trouble.

First National Bank of Seattle v. Gidden.[7]

A (the defendant) bought canned salmon from X (Gorman & Co.). According to the contract between A and X, X was to ship the salmon, free on board, from a Pacific shipping point to New York, and A was to pay the freight. X shipped 4,000 cases, drew on A and sold the draft with bill of lading attached to B (the plaintiff). B forwarded the draft and bill of lading for collection to Y, its New York correspondent (the Irving National Bank). A did not promptly accept the draft but on November 30, 1914 he finally did accept, the acceptance being payable on or before December 23, 1914, plus 6 per cent interest from date of acceptance.

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6 The court mentioned *Tuthill v. Morris*, 81 N. Y. 94 (1880) but we are unable to see that it is an authority for such a doctrine.

7 175 N. Y. App. Div. 563, 162 N. Y. Supp. 317 (1916). Affirmed, on the opinion below, 225 N. Y. 698, 122 N. E. 880 (1919).

At the same time he paid the freight as he had agreed to do in the contract made with X; the salmon was thereupon stored in a warehouse, and the warehouse receipt was substituted for the bill of lading.

On December twenty-third, a representative of A went to Y with a certified check for the amount of the draft and interest to that date, for the purpose of paying the draft and obtaining the warehouse receipt. But the draft and warehouse receipt could not be found. The representative of A departed.

The missing documents were soon found. At 3:40 o'clock on the same day Y called A on the telephone. A was reported to have gone for the day. The next day Y presented the draft several times at A's office and payment was demanded, but payment was refused, A claiming that he had wanted to ship part of the salmon to Porto Rico, and that he had been frustrated in this by his inability to get the warehouse receipt the previous day. "It is all off."

B thereafter sold the salmon at public auction; the proceeds were less than the amount due on the acceptance; and this action was brought on the acceptance, to recover the amount of the deficiency, with interest.

A set up as one *defense* the facts that he had on December twenty-third offered to pay the draft and had demanded the delivery of the draft and the warehouse receipt, and that such offer and delivery had been refused. As a second *defense* he alleged that he had had an order for 2,000 cases of salmon which he had been blocked from filling by not being able to get the warehouse receipt on December twenty-third. He also made a counterclaim for the amount of the freight which he had paid.

The trial court dismissed the complaint on the ground that B was entitled to the delivery of the warehouse receipt on December twenty-third, and that, since the draft and warehouse receipt had not been delivered to him, he was discharged from all liability upon the accepted draft. The trial court also dismissed the counterclaim. Both A and B appealed.

The Appellate Division said that the warehouse receipt was security for the payment of the acceptance, and that B was obli-

gated to meet his acceptance "irrespective of the collateral which had been given to secure its payment."

Counsel argued, said the court, that the defendant was absolutely relieved from liability on the acceptance because, when he informed Y that he had a certified check for its payment, the draft and warehouse receipt were not at once delivered. But "obviously he could not discharge his obligation to pay the draft in that way. . . . A failure to surrender the warehouse receipt did not constitute a defense to an action on the acceptance. It may be conceded that tender of the amount due discharged the plaintiff's lien on the salmon, and defendant could have replevied the same; or, if damages had been sustained, interposed a counterclaim, or maintained an action for conversion (citing *Cass v. Higenbotam*). But the fact that the collateral was not surrendered when a tender of payment was made of the draft did not relieve the defendant from his obligation to pay. That obligation continued. It was not affected by the tender or by plaintiff's neglect to return the collateral. . . . There are numerous authorities to the effect that where the drawee of a negotiable bill of exchange has accepted it, he is bound to pay in accordance with the terms of acceptance."

The court also said that B was not entitled to recover on his counterclaim for paying the freight since in so paying he was simply doing what he had contracted with X to do.

Comment:

1. As the case was presented, B did not have a leg to stand on. Assuming, but for the sake of argument only, (1) that A's failure to produce the draft and warehouse receipt amounted to a conversion, and (2) that this conversion worked a forfeiture of the pledgee's right *in rem,* nevertheless it certainly did *not* work a forfeiture of the right *in personam.* B therefore was still a creditor. A had a cause of action against B on the acceptance if B's promise was absolute. The trial court seems to have been of opinion that it was only conditional, — that B had only promised to pay, *if* at the same time A surrendered the security.

Merchants have always strongly inclined to construe promises to pay a defined sum of money (with or without interest) as abso-

lute, not conditional. A promises to B to pay a defined sum of money. That promise is absolute. Now, A makes the same promise and gives security for its performance. The argument is that thereby the promise is rendered only conditional, — that the debtor-pledgor promises to pay the debt only on condition that, as part of the same transaction, the creditor-pledgee returns the security.

True it is, that usually a debtor will only offer to pay, *if* he gets back the pledge as part of the same transaction. But due reflection will show that the law ought not to be that A's promise to pay has been rendered only conditional by the fact that he gave security. For example. A promises to pay $5,000, and gives security. The security is only worth $4,000. Then B loses or destroys it by carelessness, and so cannot produce the security. Therefore, *if* A's promise is only conditional, A gets off without paying a cent, although he should pay $1,000. Moreover, when A, a debtor, gives security, that act ought to add to the strength of the position of B, the creditor, and *do nothing but add.* It ought not to have the *weakening* effect of changing a promise " to pay," into a promise " to pay, *if.*"

Perfect justice will be done if (1) A's promise to pay money, and (2) B's promise (implied in law where there is in fact no such promise) to return the security on proper tender are viewed as *independent* promises. If both promises are broken, justice will be done through the medium of *claim* and *counterclaim.* Thus in the case just put, B has a claim (no " if " about it) for $5,000, but A has a counterclaim against B for $4,000, and therefore A should pay $1,000 (rather than get judgment with costs against B).

The *Gidden* case should be *contrasted* with *Cass v. Higenbotam.* In *Cass v. Higenbotam* the court inquired whether a conditional tender was a sufficient *basis* for a *counterclaim* by A against B. In the *Gidden* case the court is inquiring whether a conditional tender was a *defense* to A in an action by B against A. The fact that both actions were brought by B against A should not confuse. True it is that B set the ball rolling in both cases. But there was this great difference. In the *Gidden* case, A tried to make a

defense. He tried to shield himself, and he had no shield. But in *Cass v. Higenbotam,* A wisely gave ground (in argument), abandoned defense, but launched a counterattack. In that counterattack a conditional tender was sufficient because A's duty to tender was reciprocal to B's duty to surrender. B's duty was conditional only, and *therefore* A's duty was conditional only. B must surrender, *if,* but only if, payment is made by A. Then, reciprocally, A's duty is to pay *if,* but only if, surrender is made by B as part of the same transaction.

We have heard these two cases criticized as being inconsistent. We believe that they are complementary cases which are perfectly consistent, and that in both the courts reached the right results (except as stated at pp. 178–179).

2. Adequate counsel for A might have done better. He should have interposed no defense. He should not have put in a silly counterclaim asking to be paid for having done what he had by contract obligated himself to do. He should have counterclaimed for the loss of his Porto Rico market, and the damages therefor *might* have been substantial.

On reading the official report we somehow received an impression that A did not instinctively live up to his engagements and that the Porto Rico story was just a story. But it may well be that we do A an injustice. It is possible that he did have a market in Porto Rico for 2,000 cases, and that his failure to get the warehouse receipt made him miss the boat. B was responsible for Y's carelessness. That carelessness was not that kind of tort which is a conversion, but it was a tort; and, *if* that carelessness did result in damage to A, he had a good counterclaim. There was something the matter either with A's Porto Rico story, or with A's lawyer. We leave it at that.

3. B was not a converter. For centuries the courts have steadily held that carelessness, although a tort, is not that kind of tort which is known to our law as a conversion. The twentieth century tendency has certainly been to restrict, rather than to enlarge, the scope of acts which constitute conversion. But the scope would be *greatly* enlarged by making conversions (with involuntary-purchase implications) out of lacks of care. It was

certainly pretty bad for a National Bank not to have available the drafts sent to it for collection. Some clerk probably acquired local unpopularity. But there is an adequate way of dealing with such a tort (see below) without doubling or trebling the scope of conversion.

4. If there was no conversion, there was no forfeiture of the right *in rem,* and therefore replevin would *not* have lain by A against B.

The court said: "*It may be conceded* (italics supplied) that tender of the amount due discharged the plaintiff's lien (our p. 12) on the salmon, and defendant could have replevied the same, or, if damages had been sustained, interposed a counterclaim, or maintained an action for conversion."

What did the court mean by those words: "It may be conceded"? Did it mean them to be equivalent to: "Even if, for argument's sake, it be conceded"? If so, we have no quarrel with them. But if those words were meant to be equivalent to: "True it is," then we dissent and dissent *totis viribus*. There is never forfeiture of *any* bailee's right *in rem* unless the bailee is guilty of that kind of tort which is known as a conversion. No conversion, no forfeiture. That much, at least, is clear law.

Moreover, even if a court saw fit to disregard the legion of authorities, and consider the matter afresh in the light of reason, it is not sensible to change B from a secured to an unsecured creditor simply because the draft and warehouse receipt had been momentarily mislaid.

On a minor point (in which apparently nobody was interested) we think that the judgment entered was wrong. The judgment included interest. We submit that no interest should have been added to the amount due on December twenty-third. Interest is by way of damages because the payment was not made as soon as it should have been made. Well, A *would* have made the payment promptly, if B had not slipped a cog and been unable to produce the documents. It hardly lies in B's mouth to complain of lack of promptness in paying, and to get damages predicated upon a failure to pay promptly.

Loss of interest strikes us as just about the right consequence

to impose upon B for Y's carelessness, and we vote for that consequence. But we vote against imposing the consequence that B be changed from a secured to an unsecured creditor owing to the slip.

McCalla v. Clark [8]

A became indebted to B, the debt being evidenced by a note, and pledged a certificate for shares of stock in the X Company. X thereafter levied assessments on these shares and under its rules nonpayment of the assessments entailed forfeiture of the shares. Long after the maturity of the note, A tendered the amount due on the note, with interest, and demanded the certificate. B refused to surrender, upon the ground that A, by defaulting at maturity of the note, had forfeited his rights. But on the same day, after consulting counsel, B offered to return the certificate to A, if A would pay him the amount due on the note, with interest, *and* also $120 which he had paid to meet the assessments by X. A failed to tender such amount. A sued B for a conversion of the shares of stock.

B pleaded the general issue, and also filed a special plea in which he recited the facts stated above and alleged that A was insolvent, and prayed judgment against A for what was due him, and that the "said certificate of stock be directed to be sold for the purpose of refunding the same to defendant." A moved to strike the special plea, but the trial judge refused to strike it. He charged the jury that B's refusal to deliver the stock upon A's tender of the amount due on the note with interest, claiming the same to have become his individual property, constituted a conversion; but that A could not recover if B offered subsequently, before any change in the condition of the parties or in the value of the stock, to return the same on payment of the amount loaned and that paid on account of assessments, with interest. The jury found for B. A carried the case on exceptions to the Supreme Court of Georgia.

That court affirmed the judgment. It said (1) that tender of the debt on the day it became due terminates the creditor's right

[8] 55 Ga. 53 (1875).

to retain possession of a pledge; and it is an immediate conversion for him to refuse the tender and retain the pledge on a claim of title based upon an alleged forfeiture for delay to make payment; *but* (2) that if the debtor is himself in default by reason of having delayed payment beyond maturity of the debt a like refusal and claim will *not* amount to a conversion, if, on the same day, before suit is brought, and before the situation is materially changed, he retracts his refusal, after taking the advice of counsel, and then offers to accept the tender and restore the pledge, provided the tender be enlarged so as to cover charges on the pledge which the creditor had lawfully paid prior to the tender; and (3) that especially will there be no conversion, under these circumstances, where the delinquent debtor, in making the tender, omitted to include the lawful charges with which the pledge is incumbered, when he knew there were such charges, or might have known it by the use of ordinary diligence; (4) that assessments rightfully paid by the creditor upon stock pledged to him are charges upon it, in the nature of expenses, and must be refunded by the debtor as a condition precedent to reclaiming the pledge; (5) that the debt and charges are pertinent matters by way of recoupment, or in mitigation of damages, on the trial of an action of trover for conversion of a pledge; and (6) that a special plea setting them forth ought not to be stricken, even though the plea concludes, improperly, with a prayer for judgment against the plaintiff, and for a sale of the pledge to satisfy such judgment (see the headnotes).

The court, in supplement to the headnotes, said: (7) " Under the circumstances, the demand and refusal relied upon did not establish a conversion. There were lawful charges upon the property which were not tendered."

It also said: (8) " The plaintiff was a delinquent debtor and, having himself disregarded the element of time, was not in a situation to exact a very scrupulous regard of that element on the part of his creditor. . . . If the debtor had been prompt he might have had no cause to complain of the want of promptness in the creditor. It is, perhaps, not an uncommon failing to insist upon expedition which we do not practice."

It also said: (9) " It was but reasonable for [B] to have a few

hours to consult counsel on the point of forfeiture, as the day appointed by the debtor for payment had long passed."

It also said: (10) "The prayer of the special plea may have been improper, but the substance of the plea was good as matter of recoupment, or in mitigation of damages." Among the authorities referred to was Story, Bailments, §§ 315, 349.

(The numbers, 1 to 10, given above are not in the original. We have inserted them for convenience of reference.)

Comment:

1. Story made a cautious statement as to the expenses incurred by the pledgee which might be added to the debt and be secured by the pledge. There were at least *some* such expenses. "If, for instance," he said, "a horse is pawned and he meets with an injury by accident, the expenses of his cure might be justly deemed to be borne by the pawner, as they would be for his ultimate benefit. So, if goods pawned, as, for instance a ship, be injured by a storm and expenses are necessary to preserve her from absolute foundering, such expenses would seem properly to fall on the owner." [9]

We believe that he would have thought that the payment of assessments on stock which were necessary to prevent forfeiture thereof should be treated in like manner; and would therefore have agreed with the court on point (4).

That being so, A did not have a leg to stand on. An *adequate* tender by A was indispensable to put B in the position of a converter. As there was no such tender there was no conversion. Judgment for defendant, with costs.

2. Was there on all the facts a conversion by B? That is a question to which a "Yes" or "No" answer may fairly be expected; and it is one of the indispensable requisites to clear thinking that, when a question is presented to which a "Yes" or "No" answer may fairly be expected, it should be so answered. Let there be no responses, Delphic or even quasi-Delphic, to such questions. Choose your charmer, and cleave; wave t'other charmer away.

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[9] Bailments § 357.

In points (2), (3) and (7) the court said that there was no conversion. But in points (5) and (10) it said that the facts were good " as matter of recoupment or in mitigation of damages." This does not make sense unless there had been a conversion. Story in §§ 315, 349 was speaking of cases where there had been a conversion.

On the facts was there a conversion by B? The court answered " No " three times, and " Yes " two times. Let there be no wobbling about this. The proper answer to that question is " No."

3. Suppose a proper tender had been made. A *qualified* refusal by B to deliver until he had consulted his counsel would have been justifiable. Point (9). But B made an absolute refusal. Was that justifiable? It was not. A had not forefited his rights by his long delay.

Was it excusable? In point (8), the court says " Yes." Rarely will an unjustifiable withholding by a defendant be excusable. But we believe that there may be such cases.[10] No doubt, this is a doctrine which courts should apply with *great* caution, but the door should not be shut, banged and bolted against it. The judge should " listen." We believe that the dictum of the court (of course, it was only a dictum) that, even if there had been a proper tender, there was not under the circumstances of this case a conversion deserves support.

The case is very different from *Carpenter v. Dresser* in Appendix B. There the plaintiff was not a delinquent debtor. He was guiltless of all wrong. He had done nothing which even tended to make the defendant do an act which the defendant ought not to have done. But in *McCalla v. Clark* the plaintiff had so misconducted himself that the plaintiff believed in good faith that he had the right to hold on to the certificate. B slipped, but A had greased the way. The whole trouble narrowed down to the fact that B had impulsively made an absolute refusal whereas he ought to have made a qualified refusal. The notion that a pledgor forfeits his rights if he does not pay at maturity is, we have found, held by a large number of pretty intelligent persons who have

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[10] Compare p. 127.

not been trained in the law. B acted under the influence of that mistake, but his footwork was good, he quickly shifted, and A was not in the least harmed by the impulsive mistake.

To avoid any misunderstanding, we say a word further about " justifiable " and " excusable." There is no such thing as a justifiable conversion. There may be a justifiable withholding, but a justifiable withholding is not a justifiable conversion. It is *not* a conversion. It is not that kind of tort known as a conversion. It is not even any other kind of tort. It is a lawful act.

So with " excusable." There is no such thing as an excusable conversion. There may be (we think) rare cases where a withholding even though not justifiable is excusable. But an excusable, although unjustifiable, withholding is not an excusable conversion. It is *not* a conversion. It is not that kind of tort known as a conversion. It is not even any other kind of tort. It is a lawful act.

4. Note that the court did not retain the case for the purpose of a judicial sale. Point (10). B had an adequate remedy by a liquidating sale *in pais*. See our pp. 188–190.

Has the law as to tortious withholdings by pledgees changed since the time of Story?

Some of Story's expressions seem old-fashioned. The courts now do not use the words " pawn," " pawnor," " pawnee " as much as Story did. They speak, usually at least, of " pledge," " pledgor," " pledgee." Popularly, " pawn " has today [11] a plebeian connotation, while " pledge " has a patrician connotation.

It is also true that it was natural for Story to speak of a pawnee, or pledgee, as a person having a " special property," and to speak of a pawnor or pledgor as having the " general property." At one time we followed him in this. But we became convinced, in pondering over Serjeant Williams' very learned and justly famous note to *Wilbraham v. Snow*,[12] that there was at least ground for suspecting that he sometimes used " special property " in a narrow

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11 It is not uninteresting to note that three balls were the business sign of those greatest of Renaissance bankers, the Medici.

12 2 Wm. Saunders 87 (edition in 1871 by Sir Edward Vaughan Williams).

sense, connoting a right in a *lawful* possessor, and sometimes used it in a broad sense, connoting a right in *any* possessor, lawful or tortious. We could produce a catalogue of instances where there is at least ground for suspecting that other jurists on or off the bench have been guilty of the same thing. We shun like the plague any expression which has more than one meaning. In the place of "special property" and "general property" we now substitute "part owner in possession" and "part owner out of possession."

Everybody is familiar with the conception that, if A and B are tenants in common, each is a part owner. A and B have *concurrent* interests. Our suggestion is that it is equally proper to conceive that A and B, pledgor and pledgee, are both part owners, and that they have processional or *successive* interests, one preceding and the other following.

(That is a mode of expression which may usefully be applied in *all* cases of bailments, — bailments being a generic, and pledges being a specific, term).

To this extent we no longer follow in Story's footsteps. But turn from modes of expression to substance. We do not see how the law stated by Story can be improved.

We believe (1) that the law as expounded by Story, given in the first two paragraphs of this chapter, was an accurate statement of the law as it was in 1831; and (2) that, at least by the overwhelming weight of authority, the law so expounded is still law. For over a century all has been quiet on the withholding front.

And we not only believe that the law as expounded by Story *is* the law, but we also believe that it *ought to be* the law. It is simple. It is sensible. It has worn well. It is fit to survive. *It is requisite to the adequate protection of debtors.*

Chapter VII

TORTIOUS TRANSFERS OF SECOND-CLASS SECURITIES

THE pith of the distinction of the modern law of pledge from older law is that *some* conversions by pledgees do not forfeit the pledgee's right *in rem.* In the older law, *any* conversion by a pledgee did forfeit the pledgee's right *in rem* (although it did not forfeit his right *in personam*). Such a rule of law brought the big stick down on the pledgee, and, for his sins, changed him from a secured creditor into an unsecured creditor. Right there, is where the *modern* law of pledge comes in, changing the law in a very important way. *Some* conversions no longer forfeit the right *in rem.*

Let no reader, with a love of sweeping rules, embrace the idea that today the pledgee's right *in rem* is absolutely tort-proof. True it is, that it is proof against every kind of tort other than that kind which is known as a conversion. True it is, that it is also proof against *some* species of conversions. But it certainly is not proof against all species of conversions. By some species of conversions the pledgee's right *in rem* is still destructible.

Thus, we saw in the preceding chapter on Tortious Withholdings that the pledgee's right *in rem* is today no more proof against *that* species of conversion than it was when Story wrote. Furthermore, we do not feel at all sure that species No. 2 of conversion is the only species that will entail forfeiture.

But we do think that today the pledgee's right *in rem* is, and should be, proof against any tortious *transfer* of a *second-class* security. Tortious *transfers* necessarily involve the rights of third persons, and the courts for the protection of bona fide purchasers and pledgees are against forfeiture where the transferee *owing to the nature of the security* will acquire derivative rights only (see p. 22).

Some reader may ask if this desire to protect bona fide purchasers and pledgees does not indicate that the courts have confused law and equity. We think not. England long ago adopted a rule about a market-overt designed to protect bona fide purchasers (p. 23); note that this is a rule of law, not of equity. Similarly, both England and America have adopted a rule about negotiable instruments in negotiable form designed to protect bona fide purchasers and pledgees (pp. 24, 25); this is a rule of law, not of equity. Similarly, both England and America have adopted a rule about apparent ownership (possession, *plus*) designed to protect bona fide purchasers and pledgees (p. 25); even this seems to us to be a rule of law rather than of equity.

There was a maxim in the Roman Law which has been quoted times without number: *Nemo plus juris in alium transferre potest quam ipse habet.* Now, we believe that *one* of the two things that have produced the modern law of pledge was the desire of the courts to protect bona fide purchasers and pledgees of second-class securities. The courts accomplish their desire by holding that there is no forfeiture. Since they travel by that road, they do nothing contrary to this maxim from the Roman Law. B, the pledgee, has a right *in rem.* He converts the pledge by an unauthorized transfer. *But,* the courts declare that the right *in rem* is not thereby destroyed, for, if it were destroyed, the innocent third person would take nothing but the possession.

On principle, the only question would seem to be this: Is it proper for a court to hold that, where B, the pledgee, assumes to pass to C *more* than B has, the transaction between B and C shall be held to pass the lesser thing which B did have?

True it is, that analogies from the law of disseisin would lead to the forfeiture result. Thus, if the state of the title was B for life, A in fee, and B enfeoffed [1] C in fee, C's fee was defeasible by A *at once.* A did not have to await B's death to recover the land from C. But is it sensible to follow that analogy? We think not.

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[1] The *method* of conveyance made a difference. Conveyances by feoffments, fines or common recoveries forfeited whatever the conveyor had if he assumed to pass more than he had. But this was not true of a conveyance taking effect under the Statute of Uses; see the case put at p. 18.

We submit that the rule of the modern law of pledge which, for the benefit of the transferee, allows the transferee to take what the transferor might lawfully have passed is not only justifiable but is most sensible.

We said a moment ago that one of the two things that have produced the modern law of pledge was the desire of the courts to protect bona fide purchasers and pledgees of second-class securities, since they will take only *derivative* rights. The second thing was the desire of the courts not to treat with undue severity a blundering pledgee who made a liquidating sale but did not comply with all conditions precedent to a lawful sale. The modern law of pledge, as it so happens, started with a case where there had been an unauthorized liquidating sale (p. 196).

We have already seen (p. 127) that the general rule was, and is, that *any* tortious transfer by a possessor is a conversion, even if the transferor acts in good faith and with due care, — even if he has both the white soul and the gray brain. If the possessor, without the authority of the plaintiff, sets the property of the plaintiff afloat on a sea of persons, strangers to the plaintiff, the possessor has " disposed " of the property, and is, without more, a converter. There are a few exceptions to this rule but, so far as we know, there is no exception applicable to a pledgee. See the discussion of this matter in the foundation, or background, chapter on Trover and Conversion (Chapter V).

Now, if that conversion forfeits his right *in rem,* he is changed from a secured creditor into an unsecured creditor. If the debtor is financially responsible, forfeiture of the right *in rem* will not matter. A, the pledgor, has a cause of action against B for the conversion of the pledge, *but* B has a cause of action against A on the debt (the right *in personam* not having been forfeited). Criss-cross, so to speak, will produce the same result as no-forfeiture produces. If, however, A is not financially responsible, forfeiture of the right *in rem* will greatly matter. The representative of A's creditors will recover from B the full value of the pledge at the date of the transfer as determined by a jury (or other trier of the fact, p. 146). But B will only be able to obtain a dividend on his claim (" dividend " is a word which has pleasant

connotations if a corporation dividend is mentioned, but which has depressing connotations if a bankruptcy dividend is mentioned). B must receive A's successor as a guest at a feast; A's successor makes return by inviting B to a funeral.

When a pledgee had done nothing worse than to go blunderingly about a liquidating sale the courts winced at turning him, on account of his blunder, from a secured creditor into an unsecured creditor.

Even if a blundering liquidating sale does not forfeit the pledge right *in rem,* note, and note well, that it exposes the pledgee to the risk that the jury, or other trier of the fact, will make a sustainable finding (never forget that the finding will stand unless plainly wrong) that the fair market value of the pledge (at the date of the delivery pursuant to the sale) exceeded the price actually obtained; and that in such case the pledgee will be responsible for the excess. There is this much check on all unauthorized liquidating sales.

Therefore, even though an unauthorized liquidating sale will not forfeit the pledgee's right *in rem,* it is important for a pledgee that he should be well advised as to what are the rules of law regulating liquidating sales by pledgees. Accordingly, we divert from the main stream of thought to make the following summary statement of such rules:

A. At common law (their being no pertinent statute and/or agreement between the pledgor and pledgee).

1. The pledgee is not obliged to institute a proceeding in which the sale will be made pursuant to the decree, and under the supervision, and subject to the confirmation of a court. Indeed, we think that there are jurisdictions in which the courts would decline to take jurisdiction, on the ground that the pledgee has at common law a right to make a sale *in pais,* and that this gives him an adequate remedy.[2]

2. All chattels pledged may be sold. There are some statements

[2] A similar question arises as to mortgages. See, for example, the Massachusetts law as shown by the first paragraph of the opinion in *Equitable Trust Company of New York v. Kelsey,* 209 Mass. 416, 95 N. E. 850, Ann. Cas. 1912B750 (1911).

to the effect that nothing but chattels can be sold. We think, however, that the law pretty surely is that shares of stock, long-time bonds, copyrights and patents may be sold, although short-time (say, four months or less) commercial paper cannot be sold, — at least at a price which realizes less than the face value, with a discount at market rate for money.

3. The sale must be by public auction. The time and place of such auction must be reasonable. And there must be due advertisement. And the pledgee must have, in good faith and with due care, selected the auctioneer. And the auctioneer must in fact have properly conducted the sale.

4. The pledgor must have had reasonable notice of the time and place of the auction (although this notice need not necessarily have come from the pledgee). There is authority that there must also be a formal demand on the pledgor for payment. We submit that if notice of the time and place of sale is given by the pledgee to the pledgor, a demand for payment may be implied. But any adequate attorney will see to it that the pledgor receives a writing in which is stated the time and place of the sale and in which there is also a formal demand by the pledgee for payment.

5. It may be unwise for the pledgee to bid by himself, or by a dummy. A purchase by the pledgee or his dummy is not void; it is voidable, *at the election of the pledgor.*

6. There is a general duty on the pledgee to act in good faith and with due care to see to it that the property brings a fair price. If, however, he has discharged such duty, the sale stands, even if the price obtained is what would popularly be called a sacrifice price.

B. Where there is some pertinent statute and/or agreement between the pledgor and pledgee.

There are statutes on this matter in a considerable number of states, but the provisions are so diverse that no useful summary statement can be made.

Usually there is an agreement. This agreement is not necessarily enabling; it may be restrictive, — may cut down the

pledgee's common law rights. But more often it is enabling. To what extent are enabling agreements valid?

1. It is clear that an agreement that the sale may be public *or* private is valid.

2. It is clear that a waiver of demand and/or notice is valid.

3. It is probably law that a privilege given to the pledgee to bid himself is valid. But the courts scrutinize the conduct of the purchasing pledgee and the burden is on him to show that a fair price was obtained. The validity of an express agreement that the pledgee might purchase, and that, provided he himself acted properly, the sale should stand if it would have stood if a third party purchased seems to us not to be wholly free from doubt.

4. An agreement that, upon default, the pledgor shall forfeit his pledgor's interest and the pledgee shall become the absolute owner was good in Glanville's time.[3] But the law has long been otherwise. Today it is clear that such an agreement no matter how emphatically expressed is not worth the paper that it is written on. It is viewed as an unconscionably hard bargain and is stricken on grounds of public policy.

We return from this digression to the main stream of thought. The remainder of the chapter is devoted to some pertinent authorities.

We begin with *M'Combie v. Davies*.[4] B was a factor (p. 14) who had purchased tobacco for A, his principal. B tortiously pledged it to C to secure his own debt. At the time B had a lien by usage (p. 14) on the tobacco to secure repayment of £30, lent by B to A. A demanded the tobacco from C, without making a tender of £30 (or of any amount), and C, although he had the ability to deliver if he were so minded, made an absolute refusal

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[3] Laws and Customs of the Realm of England (1181), Book X, Chap. VIII. In Glanville's time, if there were no such agreement, the pledgee, on default by the pledgor, apparently had to institute a court proceeding. In such case, the court set a time within which the pledgor must redeem, and, if he did not redeem, the pledge became the absolute property of the pledgee. This is often called strict foreclosure. The idea that there should be a sale and that the net proceeds above the amount of the debt should be paid to the pledgor apparently did not come until later.

[4] 7 East 5 (1805).

to deliver. This was a conversion unless his refusal was justifiable (see our pp. 120, 124). Did he have a right to refuse to deliver until £30 was tendered? Lord Ellenborough said that the refusal was *not* justifiable, that B had no authority to pledge the property for his own debt, that this tortious act forfeited his lien, and that consequently C acquired nothing but the possession, and on the demand (without tender) and refusal became a converter.

He added: " He would have it fully understood that his observations were applied to a *tortious* transfer of the goods of the principal by the broker undertaking to *pledge* them as *his own;* and not to the case of one who, intending to give a security to another to the extent of his lien, delivers over the actual possession of goods, on which he has the lien, to that other, with notice of his lien, and appoints that other as his servant to keep possession of the goods for him; in which case he might preserve the lien."

In a word, the court made C suffer because B had assumed to pass more than he had, although the court recognized that B might have lawfully given to B the benefit of what he did have.

This decision did not seem sensible to business men. At their insistence Parliament intervened and the merchants triumphed, much as they had triumphed in Lord Holt's day on another matter (p. 92). The earliest statute only gave C the benefit of what B had. But, later, C's rights were enlarged so that his rights were *independent* and not merely derivative. See the American statutes given in note 6 on our page 26. *M'Combie v. Davies* was a bad decision that led to good statutes, amounting to *more* than a reversal of the bad decision.

We pass to an American case, *Jarvis v. Rogers.*[5] The facts in this case are somewhat complicated; the judges divided, three to two, on the point principally discussed; four of the five opinions are not short; and the case has not infrequently been misunderstood, or at least only partially understood.

A (Jarvis) employed B (Russell) as his agent on various business matters. He also, from time to time, borrowed money from B,

[5] 15 Mass. 389 (1819).

or from B and B's associates. A owned some certificates of beneficial interest issued by trustees in whom the title to certain lands in a southern state had been lodged, called "land-scrip." These certificates were by their terms transferable by indorsement and delivery. They were intended to be in business substance like certificates for shares of stock in a corporation (see Corporate Advantages without Incorporation, pp. 327 *et seq.*). A became indebted to B and B's associates (the Greenleaf notes for over $20,000). B received for safekeeping A's land scrip which A had indorsed in blank. Later, A borrowed $500 from B, and there was an express agreement that the land scrip was pledged to secure repayment of the $500. Still later, A in a letter to B used expressions indicating that it lay in A's mind that the land scrip was security for the $20,000 notes as well as for the $500. Still later, B borrowed $1,000 from C (Rogers) and pledged A's land scrip to secure payment.

A died insolvent, and much litigation ensued. Finally the question became: Is the successor of A, or the successor of B, the person entitled to redeem from C? C was protected for his $1,000 on the principle of possession, *plus* (see our pp. 25, 26). There was at that time no way by which C could interplead the successors of A and B but there was apparently some agreement or understanding between counsel to the effect that C should have his $1,000, and that his only duty should be to turn over the certificates, upon receiving what was due to him, to such party as the court decided had the superior right of redemption. In a word, there was an informal interpleader.

The principal question, therefore, was whether the land-scrip was security for the $20,000 notes as well as the $500, or only for the $500. Three judges (Parker, C.J., Thatcher, J., and Wilde, J.) thought that it was security only for the $500, and as this amount would be more than paid by the payment of $1,000 to C they concluded that A's successor had the right to redeem. Two judges (Jackson, J., and Putnam, J.) thought it was *also* security for the $20,000 notes and that consequently B's successor was entitled to redeem, and to hold the scrip until all debts due from A to B were discharged. This was important since A was insolvent when he died.

We are only concerned with the opinion of Mr. Justice Jackson, one of the two minority judges. He thought that B acquired a pledge interest for the $20,000 notes as well as for the $500. Then he asked: Did B *after* acquiring such large pledge interest do anything to forfeit it? *Did he forfeit it by pledging it for his own debt?*

Here he gets interesting. For he pointed out that it was not proper for a factor to pledge consigned goods as security for his own debt and that if he did so he forfeited his factor's lien, but that, nevertheless, this was *not* true with respect to a pledgee. The retention of possession by the pledgee *himself* was not vital to a continuance of the pledge. He concluded his review of the authorities by saying: "From these cases, it appears that the pawnee may deliver the goods to a stranger without consideration, or he may sell and assign all his interest absolutely, or he may assign it conditionally by way of pawn, — without, in either case, destroying the original lien, or giving to the owner a right to reclaim them on any other or better terms than he could have done before such delivery or assignment." [6]

We feel confident that no one of the other four judges had any disposition to quarrel with him over this point.

Now, note that this statement by Mr. Justice Jackson is no authority as to what happens when a pledgee of *second-class* security makes a second pledge for an amount *larger* than the debt due to him. Here the security was first-class (p. 22). All five judges held that C got what he thought he was getting. And, even if the security were viewed as second-class, Mr. Justice Jackson was not urging that B could give to C *larger* rights than B had — he thought that B had rights for over $20,000 (and B had borrowed from C only $1,000).

But Mr. Justice Jackson's remarks are valuable as being (so far as we know) the first time that the case of the factor who pledges for his own debt and the case of the pledgee who makes a second pledge for his own debt were placed side by side, and it was stated that, although by his pledge the factor's lien was forfeited, nevertheless the second pledge of the pledge did not forfeit the pledgee's right *in rem*.

[6] 15 Mass. 408, 409.

The first edition of Story on Bailments was published in 1831. He said: " In the next place, as to the right of the pledgee to alienate the property. It is very certain, that at the common law he cannot alienate the property absolutely, nor beyond the title actually possessed by him, unless in very special cases. But if the pledge is of mere current coin, or of negotiable securities, capable in their own nature of passing by delivery, there, if the pledgee sells it to a *bona fide* purchaser without notice, the latter acquires an absolute property in the pledge. For in a concurrence of equal rights, he, who has trusted the party, and enabled him to impose upon another, shall be bound by his acts. Thus, if the pledge is of a certificate of stock, which may pass by delivery, a *bona fide* purchaser, or subsequent pledgee, may hold the stock against the real owner (citing *Jarvis v. Rogers*). The like rule applies to negotiable securities.

" But if a negotiable note, or other security, contains on it any intimation, that it belongs to another person, or is for his account, there it is incapable of being pledged for the use of the holder. And the rule, in respect to negotiable securities, seems confined to cases of securities, which pass as money. For although a bill of lading of goods is negotiable, yet if the consignee has a mere lien for advances, he cannot pledge them by indorsing the bill of lading, (although he may sell them,) even if the pawnee is ignorant, that he is not the owner; unless indeed the owner should have enabled him so to act by holding him out to the world exclusively as owner; for then he might be bound by the pledge.

" The pawnee may, by the common law, deliver over the pawn into the hands of a stranger for safe custody without consideration; or he may sell or assign all his interest in the pawn; or he may convey the same interest conditionally, by way of pawn to another person; without in either case destroying or invalidating his security (citing *Jarvis v. Rogers*). But if the pledgee should undertake to pledge the property (not being negotiable securities) for a debt beyond his own, or to make a transfer thereof to his own creditor, as if he was absolute owner; it is clear, that in such a case he would be guilty of a breach of trust; and his creditor would acquire no title beyond that held by the pawnee. The only

question, which, under such circumstances, would seem to admit of controversy, is, whether the creditor should be entitled to retain the pledge until the original debt was discharged, or whether the owner might recover the pledge, as if the case was a naked tort, without any qualified right in the first pledgee.

" The doctrine of the common law now established in England, after some diversity of opinion, is, that a factor, having a lien on goods for advances, or for a general balance, has no right to pledge the goods; and if he does, he conveys no title to the pledgee. The effect of this doctrine is, in England, to deny to the pledgee any right in such a case to retain the goods, even for the advance or balance due to the factor. In short, the transfer is deemed wholly tortious; so that the principal may sue for and recover the pledge without making any allowance or deduction whatsoever for the debts due by him to the factor. The inconvenience, not to say harshness, of the latter part of the doctrine has been very seriously felt in England. And what renders it somewhat objectionable in principle is, that it is admitted, that the factor has a right to assign or deliver over the goods, as a pledge or security, to the extent of his lien thereon, if he avowedly confines the assignment or pledge to that, and does not exceed his own interest. Now, if the right or lien of the factor is capable of assignment or transfer at all, as an interest or right adhering to the goods, and entitled to accompany the possession, there seems great difficulty in maintaining, that, because the title to the pledge is infirm in part, upon a general transfer or a general pledge, it shall be bad in toto, notwithstanding the pledgee may be an innocent *bona fide* holder. The general denial of the right to pledge by factors does not appear to have approved itself to the minds of Lord Eldon and Lord Ellenborough; and it has been suggested by Mr. Bell, that it probably had its origin in mistake. Parliament, however, has at length interfered, and placed the doctrine on this subject upon a far more rational foundation, than it was placed by the decisions of Westminster Hall.

" In America the general doctrine, that a factor cannot pledge the goods of his principal, has been frequently recognised (citing *Jarvis v. Rogers*). But it does not appear, as yet, to have been

carried to the extent of deeming the pledge altogther a tortious proceeding, so that the title is not good in the pledgee even to the extent of the lien of the factor; and [so that] the principal may maintain an action against the pledgee without discharging the lien, or at least without giving the pledgee a right to recoup the amount of the lien in the damages. Considering the present state of the English Law on this point, and the unsatisfactory principle, on which the former doctrine rests, it would perhaps be matter of regret, if the American Courts should feel themselves constrained, by the pressure of authority, to yield to it.

"But whatever doubt may be indulged as to the case of a factor, it has been decided, that, in case of a strict pledge, if the pledgee transfers the same to his own creditor, the latter may hold the pledge, until the debt of the original owner is discharged (citing *Jarvis v. Rogers*). And it has been intimated, that there is, or may be a distinction favourable to the pledgee, which does not apply, or may not apply to a factor, since the latter has but a lien, whereas the former has a special property in the goods (citing *Jarvis v. Rogers*). It is not very easy to point out any substantial distinction between the case of a pledgee and the case of a factor. The latter holds the goods of his principal, as a security and pledge for his advances and other dues. He has a special property in them, and may maintain an action for any violation of his possession either by the principal or by a stranger. And he is generally treated, in juridical discussions, as in the condition of a pledgee." [7]

We regard these passages from Story as the foundation of the modern law of pledge.

To go back to England. In 1863, came the decision of *Johnson v. Stear.*[8] A borrowed from B 62 pounds, 10 shillings upon the security of certain brandies then lying in the London Docks, handing him the dock warrant, and also a memorandum in which he agreed that, if the debt were not paid on January 29, 1863, B

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[7] §§ 322–327.

[8] 15 C. B. (N.S.) 330, 33 L. J. C. P. 130, 9 L. T. (N.S.) 538, 10 Jur. (N.S.) 99, 12 W. R. 347 (1863)

might without notice to A sell the goods by public or private sale (see our p. 190), applying the net proceeds to the payment of the loan. A absconded on the fifth of January, 1863, and was declared a bankrupt on the seventeenth of January, 1863, and the plaintiff was the representative of A's creditors. On the twenty-eighth of January, 1863, B contracted to sell the brandies to C; on the twenty-ninth, he delivered the dock warrant to C; on the thirtieth, C took possession of the chattels. The plaintiff brought trover against B.

Under the direction of the trial judge, the jury returned a verdict for the plaintiff, assessing the value of the brandies at 62 pounds, 10 shillings. A rule nisi was granted, and counsel for B argued that the plaintiff was entitled only to nominal damages, inasmuch as there was no pretence for supposing that the bankrupt intended to redeem the brandies, and that, although the delivery was a bit premature, the defendant was not therefore to lose the advantage of his pledge interest in determining the rights of the pledgor against the pledgee.

The court was divided in opinion, three to one. Williams, J., thought that B's right *in rem* was annihilated by the premature transfer, that A might have resumed possession of the goods from anyone who had got the possession, and therefore that he could recover the *full value* from B. And he saw no injustice in B's being remitted to an unsecured debt, since his interest in the goods had been forfeited by his wrongful act. In a word, he did not wince at turning B from a secured creditor into an unsecured creditor, even though the right *in personam* against A was, as a practical matter, of little or no value.

But the other three judges ruled that the damages should be reduced to 40 shillings (which counsel for B was apparently willing to regard as nominal damages). Erle, C.J., delivered the opinion of the majority. He said that there were two questions: First, had there been a conversion by B? Second, if so, what should be the measure of damages?

His answer to the first question was "Yes." The *delivery* on the twenty-ninth pursuant to a sale was a tortious transfer. (The reader will note that it is the tortious transfer made by the de-

livery pursuant to the sale, and not the sale, which is the conversion). But B had an interest which was more than a "mere lien," and the wrongful act of B "did not annihilate the contract between the parties *nor* (italics supplied) the interest of the pawnee in the goods under that contract. It is clear that the actual damage was merely nominal. The defendant by mistake delivered over the dock warrant a few hours only before the sale and delivery by him would have been lawful; and by such premature delivery the plaintiff did not lose anything, as the bankrupt had no intention to redeem the pledge by paying the loan."

Comment:

1. A perusal of the opinions will show that both Erle, C.J., and Williams, J., quoted at length from Story. England has exported many ideas to America; but has maintained a rather stiff mental tariff against importation of ideas. But Story's ideas were so good, that they were imported, tariff or no tariff. This tended toward balancing.

2. All the judges took it in their stride that the tortious transfer by a premature delivery of the property pledged was a conversion (see our p. 358).

The main question was whether the right *in rem* had been annihilated by the conversion. Could there be a conversion which did not entail forfeiture of the right *in rem?* Williams, J., was of the old guard. He planted himself on the authorities. *Stare decisis.* He would die, but not surrender. But with the majority common sense prevailed over the authorities.

This decision is, so far as we know, the first *decision* in England or America that a conversion by a bailee (bailee is the generic term; a pledgee is one kind of a bailee) did not necessarily entail forfeiture of the bailee's right *in rem.* This is a decision that a conversion, even if it *did* entail forfeiture by a *factor,* did *not* entail forfeiture by a *pledgee.*

The importance of that decision does not strike the mind at first reading. But it was the spring, the source, from which streams of authorities have flowed, and these streams have increased in volume from then on and are still increasing.

3. There had been a conversion. But what had been converted? *Not the brandies, but only the pledgor's interest therein.* A pledgor's interest is the value of the property pledged, *less the debt.* As the brandies were worth only the amount of the debt, there was no pledgor's interest.

4. Logically, judgment should have been for the defendant, instead of for the plaintiff with so-called nominal damages. But B was in the hands of wise counsel. We conjecture that he was well content with the result. His client had slipped a cog, and he soothed the minds of the majority of the court by not asking that his client get off scot-free. In a case arising later [9] on like facts, the court did the logical thing, and entered judgment for the defendant.

The lead given by *Johnson v. Stear* has been repeatedly followed. The authorities are collected in the standard encyclopedias.

In the bulk of such cases the pledgee had been no worse than a blunderer. The pledgor had defaulted, the law contemplates that a default may, and usually will, lead to a liquidating sale, and the only ground for complaint against the defendant was that he had blundered and failed to comply with some condition precedent to a liquidating sale. *Any* slip, which makes a sale intended as a liquidating sale an unauthorized sale, exposes the pledgee to the risk that a jury will make a sustainable finding that the fair market value of the property was more than the actual proceeds of the sale (p. 146). This risk is, we submit, enough of a deterrent in such cases. It is not good sense every time the pledgee slips a cog to turn him from a secured into an unsecured creditor of a debtor who has defaulted.

The no-forfeiture rule in such cases is, we believe, of advantage to debtors as a class. A forfeiture rule tends to chill the lending of money at a *lower* rate because property is pledged to secure it.

We believe that it is clear law today that, if the liquidating

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[9] *Halliday v. Holgate,* L. R. 3 Exch. 299, 37 L. J. Ex. 174, 18 L. T. (N.S.) 656, 17 W. R. 13 (1868). See our comments on this at pp. 346–347.

pledgee has had a white soul, then, even if he has not had the gray brain, there will be no forfeiture predicated upon a delivery under an unauthorized sale intended as a liquidating sale.

Suppose the pledgee did not have the white soul. Suppose he had been unfair. In *Whitman v. Boston Terminal Refrigerating Co.,*[10] the pledgee, a corporation, had a right to sell after default at private sale. It sold to a subsidiary corporation at a price below fair market value. Should there be a *forfeiture* for that? The case is not an authority upon the point. The plaintiff seems not to have asked for forfeiture, and seems to have been content with obtaining the value of the pledgor's interest.

On principle, *should* there be forfeiture in such a case? We regard that as a question upon which the law is not yet clear. We submit that, even in such a case, there should be no forfeiture, and that the plaintiff in the *Whitman* case obtained all that he ought to have obtained. We believe that a forfeiture rule would be a boomerang to debtors as a class. It is so easy to make charges of unfairness, and it is sometimes possible to make juries believe that there was unfairness. No; if the debtor defaults, and there is a liquidating sale, let the law be that under no circumstances may the pledgor, or the representative of the pledgor's creditors, recover more than the amount by which the fair market value of the property (at the date of the delivery made pursuant to the sale) *exceeded the debt*. We repeat that, in our judgment, the risk that there will be a sustainable finding that fair market value exceeded the actual proceeds is a sufficient deterrent.

Dimock v. United States National Bank.[11] We insert this case in this chapter, because the court speaks of one point which is relevant even if the security is second-class. A borrowed $50,000 on a *time* loan; agreed to make a payment on account if (1) the market price of the security fell, and (2) a payment was demanded; and authorized B to sell, forthwith under default. On May 6, 1884

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[10] 233 Mass. 386, 124 N. E. 43 (1919).

[11] 55 N. J. L. 296, 25 Atl. 926, 39 Am. St. Rep. 643 (1893).

Grant, Ward & Co. failed, a panic ensued, and there was a great depreciation in the market value of the pledge. B *without* making a proper demand for a payment on account sold the pledged shares of stock on May 15, 1884. This sale was made through a firm of brokers who were members of the New York Stock Exchange, and there was no basis for complaint of the manner or fairness of the sale. The proceeds of the sale were something over $45000, and these were applied by B on the note.

In 1891, this action was brought to recover the deficiency. A claimed that B had converted the shares of stock, and that the measure of damages for such conversion was the highest market price between the time of the conversion and the trial, relying on *Markham v. Jaudon* [12] (for a full statement of the New York case see our pp. 260–262).

But the court said that *Markham v. Jaudon* had been overruled by a series of cases in the New York courts [13] and a different rule adopted to the effect that A might recover "the advance in the market price from the time of sale up to a reasonable time to replace it, after the notice of the sale." It noted that, under the decisions of the New York courts, what is a "reasonable time" is to be determined by the court, where the subsidiary facts are undisputed, and that in *Colt v. Owens* [14] thirty days after the sale and notice of it was regarded as reasonable time. It also noted that the rule that damages shall be "the highest intermediate value between the time of the conversion and a reasonable time after the owner has received notice of it, was adopted as the correct view of the law" by the Supreme Court of the United States.[15] It accepted the later New York rule as satisfactory, *but with a supplement.*

The court was dealing with a time loan. B owed a duty to A to keep the pledge in hand at all times ready for delivery upon

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[12] 41 N. Y. 235 (1869).

[13] *Baker v. Drake,* 53 N. Y. 211, 13 Am. Rep. 507 (1873), our p. 265; *Gruman v. Smith,* 81 N. Y. 25 (1880), our p. 280; *Colt v. Owens,* 90 N. Y. 368 (1882), our p. 281.

[14] 90 N. Y. 368 (1882), our p. 281.

[15] *Galigher v. Jones,* 129 U. S. 193, 32 L. Ed. 658, 9 Sup. Ct. 335 (1889).

payment of the debt. "Under such circumstances a rule that the pledgor shall be at liberty to elect to treat the unauthorized sale as a conversion *or* (italics supplied) to hold the pledgee for the breach of his duty to keep the securities until the maturity of the debt, and recover in damages the market value of the securities as of that time would commend itself in reason and justice."

We have heard it said that the rule in the *Dimock* case is that the unauthorized sale is a conversion, and that the damages for the *conversion* are to be determined by reference to the highest intermediate value of the securities between the sale and the expiration of a reasonable time after notice of the sale to the pledgor, *or,* if the pledgor so elects, the value of the securities at the maturity of the note.

We do not so understand the thought of the court. We submit that the thought of the court was that delivery pursuant to an unauthorized sale was a conversion, and that the damages for such *conversion* were to be determined by reference to the highest intermediate value of the securities between the sale and the expiration of a reasonable time after notice of the sale to the pledgor. So far as the pledgor had a cause of action in *tort,* that was all there was to it.

But the pledgee is under a duty to have the securities on hand for surrender upon a proper tender. If he fails to meet a tender he is liable for breach of contract. But his inability to deliver upon tender is not a conversion.

If our understanding of the thought of the New Jersey court is correct, we submit that the New Jersey rule is a good rule. Under that rule the pledgor has an *option.* He may sue for a conversion. In such case the damages will be the excess over the debt of the pledge valued at the highest market price between the date of the conversion and the expiration of a reasonable time after notice to the pledgor. (For a full statement of our reason for supporting this rule as to measure of damages rather than the *Salmon Weed* rule, see pp. 269–273.) *Or,* he may at the maturity of the debt, tender and demand, and, if he does not get what he is entitled to, may recover the value of the pledge *at that date* less the debt.

On doubtful questions, we think that the law should incline to

restrict rather than to enlarge the scope of conversion. Therefore we incline against the idea of a second conversion by the same defendant. Moreover, in any event, there can be no second conversion because securities are not on hand which should have been on hand; he who does not hold cannot withhold (see our pp. 120–123). For these reasons, we are strong against treating the value of the securities at the date of the maturity of the debt as having anything to do with the damages in *conversion*.

In connection with the reasoning in the *Dimock* case, we call attention to the interesting case of *Wilkinson v. Verity*.[16] A (churchwardens of a certain church) entrusted the silver service to B (the vicar). B tortiously sold it as old silver and delivered it to the purchaser. More than six years later, A demanded the service from B, and, on B's failure to produce, brought detinue. B pleaded the Statute of Limitations. The court held that the sale and delivery was a *conversion* and that the cause of action for *that* was barred by the statute, *but* that on demand and refusal there was a *new* cause of action in *contract* to which the statute was *not* a bar.

The court said: " The rule that a cause of action arises once for all upon the first default is, however, not universal; for, in cases where a man undertakes to do an act upon a future day, and before the day arrives disables himself from performing the act, or positively and absolutely refuses to be bound by or perform his contract, and, so to speak, declares off the bargain himself, and absolves the opposite party, it is in the option of such party at his election to treat that conduct as of itself a violation and breach of the contract, or to insist upon holding the repudiating party liable, and sue him for non-performance when the day arrives. The misconduct of the party who acts in fraud of the bargain in such cases gives the other party thereto the election of suing either for the first violation or for non-performance at the day; and it does not furnish the wrong-doer with any answer to the latter." Then: " On the other hand, if the action of detinue is resorted to, as it may be (Com. Dig. Detinue A.), for the purpose of asserting against a person intrusted for safe custody a breach of his duty

16 L. R. 6 C. P. 206, 40 L. J. C. P. 141, 10 W. R. 604 (1871).

as bailee, by detention after demand, independent of any other act of conversion, such as would make him liable in an action of trover, it should seem that the owner is entitled to sue, at election, either for a wrongful parting with the property (if he discovers and can prove it), or to *wait* (italics supplied) until there is a breach of the bailee's duty in the ordinary course by refusal to deliver up on request; and that, in the latter case, it is no answer for the bailee to say that he has by his own misconduct incapacitated himself from complying with the lawful demand of the bailor."

So far, we have dealt only with unauthorized liquidating sales. The litigation has been between A, the pledgor, and B, the wrong-doing pledgee. We pass to cases where the rights of C, a bona fide purchaser or pledgee of second-class securities, are involved.

There are two leading cases on this, one English and one American.

The English case is *Donald v. Suckling*.[17] A deposited debentures with B as security for the payment, at maturity, of a bill, agreeing that B might sell, if there was a default. *Before* the maturity of the bill B pledged the debentures to C as security for the payment of a loan to B made by C. There was a default by A, and while the A, B bill remained unpaid, A brought detinue against C for the debentures, without making any tender of the amount of such bill either to B or C. Shee, J., thought that the plaintiff should succeed, but Cockburn, C.J., and Blackburn and Mellor, JJ., thought he should not.

No statement is made in the report as to the character of the debentures. But Blackburn, J., said that C "could not in any view have a greater right than [B] had,"[18] and that B "was not an agent within the meaning of the Factors Acts."[19] He therefore treated the security as second-class (our p. 22), and none of the other judges quarreled with him on that. C, at most, had *derivative* rights only.

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[17] L. R. 1 Q. B. 585, 7 B. & S. 783, 35 L. J. Q. B. 232, 14 L. T. (N.S.) 772, 30 J. P. 565, 12 Jur. (N.S.) 795, 15 W. R. 13 (1866).

[18] *Ibid.*, p. 611.

[19] *Ibid.*, p. 612.

Three of the four judges proceeded on the assumption that the debt from B to C was for a larger amount than the debt from A to B, and the headnote so states. Blackburn, J., however, made a more cautious statement, saying that the B, C debt " may or may not have exceeded the amount of the bill of exchange, but was certainly different from it." [20]

Shee, J., thought that the pledge interest ceased, at the moment when the pledgee, B, transferred the possession to C. The tortious transfer annihilated the right *in rem.*

Cockburn, C.J., thought it unnecessary to decide whether the right *in rem* passed to C.[21] He decided against the plaintiff on the principle that a pledgor cannot recover property pledged for the payment of a debt until he has paid or tendered the amount of the debt.[22]

Blackburn, J., thought that, if there still remained in B or C, as the assignee of B, any right of detention, A must fail in detinue; [23] that the question was whether the transaction between B and C " put an end to that interest and right of detention till the bill of exchange was honoured "; and that there was " a great difference in this respect between a pledge and a lien "; [24] that a pledge " does give the pledgee something beyond a mere lien; it creates in him a special property or interest in the thing "; [25] that in England there were " strong authorities that the contract of pledge, when perfected by delivery of possession, creates an interest in the pledge, which interest may be assigned." [26] He was not prepared to say that such interest might not be lost " where the act complained of is one wholly repugnant to the holding " [27] but that " the subpledging of goods, held in security for money, before the money is due, is not in general so inconsistent with the contract, as to amount to a renunciation of that contract. There may be cases in which the pledgor has a special personal confidence in the pawnee, and therefore stipulates that the pledge shall be kept by him alone, but no such terms are stated here, and I do not think that any such term is implied by law. In general all

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[20] *Ibid.*, p. 611.
[21] *Ibid.*, p. 618.
[22] *Ibid.*, pp. 619, 620.
[23] *Ibid.*, p. 611.
[24] *Ibid.*, p. 612.
[25] *Ibid.*, p. 613.
[26] *Ibid.*, p. 613.
[27] *Ibid.*, p. 615.

that the pledgor requires is the personal contract of the pledgee that on bringing the money the pawn shall be given up to him, and that in the meantime the pledgee shall be responsible for due care being taken for its safe custody. This may very well be done though there has been a subpledge; *at least the plaintiff should try the experiment whether, in bringing the money for which he pledged these debentures to [B], he cannot get them.*" (Italics supplied.) [28] Note that we shall return to the statement in italics in the discussion of *Wood v. Fiske* at our p.246.

He further said that, if the second pledge was "done too soon, or to too great an extent, it is doubtless unlawful, but not so repugnant to the contract as to be justly held equivalent to a renunciation of it"; [29] that *Johnson v. Stear* (our p. 196) was "an authority that at all events there remains in the pawnee an interest, not put an end to by the unauthorized transfer, such as is inconsistent with a right in the pawnor to recover in detinue." [30] He concluded by saying: "I think that unless the plaintiff is entitled to the uncontrolled possession of the things, he cannot recover in detinue." [31]

Mellor, J., also emphasized the difference between lien and pledge, recognized that there might be a contract express or implied from the circumstances of the case against assignment, but thought that there was none here and that in the absence of such a contract a pledge by B to C for a greater interest than B has "does not *annihilate the contract of pledge* between himself and the pawnor; but that the transaction is simply inoperative as against the original pawnor, who *upon tender of the sum secured immediately becomes entitled to the possession of the goods,* and can recover in an action for any special damage which he may have sustained by reason of the act of the pawnee in repledging the goods." [32] (Italics supplied.)

Comment:

1. Three judges held that B's act did not put an end to the contract of pledge between A and B, *or* B's interest and right of

[28] *Ibid.*, p. 615.

[29] *Ibid.*, p. 616.

[30] *Ibid.*, p. 616.

[31] *Ibid.*, p. 617.

[32] *Ibid.*, p. 610.

detaining the *res,* and that, therefore, A could not maintain detinue without having paid or tendered the amount of the A, B debt.

2. The case cannot properly be held to be an authority that a tortious pledge from B to C for a larger debt than the A, B debt vests in C the right *in rem* which B had. The court did hold that that right *in rem* still existed, but it found it unnecessary to decide whether that right had remained in B or had passed to C. It was enough to defeat A that that interest was still outstanding, whether it was in B or C.

3. Therefore the case is not helpful as to whether A should make tender to B or C.

4. No judge committed himself to a sweeping rule that *no* tortious transfer would annihilate the right *in rem.* On the contrary, all seem to have thought that there might be acts so utterly inconsistent with the contract of pledge that they would annihilate the right *in rem.* But they did not specify what acts would have that effect.

5. The case followed the lead given by *Johnson v. Stear.* In that case a slightly premature delivery pursuant to a sale intended as a liquidating sale did not annihilate the right *in rem.* In this case, the fact pretty surely was that the B, C debt was larger than the A, B debt (although there was room for an argument that this had not been alleged). The opinions of Cockburn, C.J., and Mellor, J., are based on the assumption that such was the fact. Blackburn, J., paid stricter attention to the form of the pleadings, but we have no doubt that he would have reached the conclusion that he did reach even if it had been expressly alleged that the B, C debt was larger than the A, B debt.

We think that the case has a strong tendency to show that, if B pledges to C second-class securities for a larger amount than A owes B, this tortious act is a *conversion,* but a conversion only of the pledgor's interest.

The American case is *Talty v. Freedman's Savings & Trust Company.*[33]

A (Talty) employed B (Kendig) to sell A's negotiable note for $3,000, payable in 60 days, with interest. (This note was made payable to A and indorsed by A in blank.) A also entrusted B

[33] 93 U. S. 321, 23 L. Ed. 886 (1876).

with a certificate of indebtedness for about $6,000 for work and materials, which certificate was issued by the city of Washington to A, and indorsed by A in blank. This was to be used as security for the payment of the note. The same day B sold the note to X, and B paid A an amount equal to the face of the note less a discount. Then B sold the certificate of indebtedness to C (Freedman's Savings & Trust Company) for ninety-six cents on the dollar. C made the purchase in good faith and without notice of any right or claim on the part of A. B with part of the money obtained from C took up the note from X. This note was in the hands of B a few days before its maturity and the court said that, there being no proof to the contrary, it would be presumed that X held the note at maturity.

A few days before maturity, A called on B, offered to pay the note, and demanded the security. B, of course, could not comply with the demand. After the maturity of the note, B demanded the certificate from C, *without tendering anything to anybody.* C refused to surrender.

A brought an action of replevin against C, thereby obtained the certificate, and the city of Washington subsequently paid him the full amount. The trial judge in the replevin action instructed the jury to find for C, and to assess the amount payable by A to C under the terms of the replevin bond (given by A on replevying the certificate) as the full amount specified in the certificate of indebtedness. Judgment was entered upon the verdict.

The case was brought by writ of error from the Supreme Court of the District of Columbia to the Supreme Court of the United States. The judgment was affirmed.

The court said that the question was: Whether a tender to C by A of the amount due on the note before replevying was indispensable? The answer to that question was "Yes." B was not a factor with a mere lien. He was a pledgee. The court then quoted Story's statements that a pledge is assignable (our pp. 194–196). It also cited *Jarvis v. Rogers* (our pp. 191–193) as an authority for the assignability of a pledge, and also cited a New York case to the same effect. It also cited *Donald v. Suckling* (our p. 204), treating it as a case where the second pledge was for

a larger amount than the A, B debt. It then said: "A tender to the second pledgee of the amount due from the first pledgor to the first pledgee extinguishes *ipso facto* the title of the second pledgee (see our pp. 17–18); but that there can be no recovery against him without tender of payment is equally well settled. *Donald v. Suckling, supra; Jarvis's Adm. v. Rogers, supra.*"

Comment:

1. B did not have a pledge interest in the certificate of indebtedness at the time he sold it to C. The note had been indorsed in blank by A, and there is no proof that B also indorsed it when he sold to X, and it is highly improbable that B did indorse it; therefore B did not need the security for his own protection. A's name was apparently better than he had supposed, — in any event, B had succeeded in selling the note as an unsecured note. Under those circumstances it is possible to urge that there was a constructive trust upon the certificate in favor of X, but we submit that the more sensible view is that B owed a duty to return the unneeded certificate to A, and therefore that the constructive trust was in favor of A, not X.

If B had no pledge interest, then C could not properly be treated as an assignee of a pledge interest. This point at one time greatly troubled us, but at long last it has ceased to trouble. A received the money which he expected to receive, and he did not expect to get back the certificate until he had paid the note. The order of events made no difference to him. It is no injustice to him to give the same result as would have been given *if* B had had a pledge interest at the time of the sale to C. Counsel for A did not make the point, and we do not have the benefit of knowing how the court would have disposed of it, if it had been made. But we feel pretty confident that the court would have in some manner disposed of it. We incline to think that, at least as a general rule, even a court of *law* should protect a bona fide purchaser or pledgee, *if* such protection does not infringe the rights or disappoint the just expectations of anyone else.

2. Both counsel seem to us to have gone fast asleep. There was certainly a basis for urging, on behalf of C, that the principle

of possession, *plus* (see our p. 24) applied, and therefore that C's rights were independent, and not merely derivative. But for some reason counsel for C did not argue the point. The court said: "But as the point has not been argued, we express no opinion upon the subject."

But it was nap for nap. *If* the security was second-class then, when A improperly replevied, he took from C a $6,000 certificate in which C had only a $3,000 interest. It is well settled that if a bailor improperly takes the bailed property from a bailee, the bailee may recover, not the full value of the property, but only the value of the *bailee's interest*.[34] Therefore, the damages should have been $3,000, not $6,000. The court said: "In the discussion here our attention was called only to the question of tender; nothing was said as to the rule of damages laid down by the court below."

3. The case was dealt with by the Supreme Court of the United states as a case where A pledged second-class security to B, and B tortiously sold the security to C, a bona fide purchaser. It treated C (1) as the assignee of B, *and* (2) as the person to whom A must make the tender.

4. In *Donald v. Suckling,* some of the judges had been careful to say that the pledge interest might be annihilated if the tortious act was one so repugnant to the contract as to be justly held equivalent to a renunciation of it. We can think of no act which may more justly be held equivalent to a renunciation by a pledgee of his contract than his act of assuming to be the absolute owner and selling the pledge as owner. But the Supreme Court of the United States *extended* the doctrine of *Donald v. Suckling* without being at all troubled by the fact that it was extending the doctrine of that case.

The first no-forfeiture decision was *Johnson v. Stear* in 1863, where no-forfeiture was applied in favor of a pledgee, creditor of an insolvent debtor, when the pledgee made delivery pursuant to a liquidating sale a day before it was proper. It is interesting

[34] Some of the authorities are *Chamberlin v. Shaw,* 18 Pick. (Mass.) 278, 29 Am. Dec. 586 (1836); *Ingersoll v. Van Bokkelin,* 7 Cow. (N. Y.) 670, 680 (1827); *White v. Webb,* 15 Conn. 302, 305 (1842); *Benjamin v. Stremple,* 13 Ill. 466, 468 (1851).

to note that within thirteen years this no-forfeiture principle was applied, *for the benefit of C, a bona fide purchaser of second-class security,* in a case where the pledgee, B, was a rascal and assumed, before any default by A, to sell the security as his own property.

We submit that the no-forfeiture principle was rightly extended to such a case, and that the decision is a proper and natural development of Story's thought. We are confident that most, if not all, American courts will follow the lead given by the *Talty* case. As to whether the English courts will also follow it, we make no prediction.

In review of the whole subject of tortious transfers by pledgees of second-class securities:

1. The right *in rem* of a pledgee is assignable; retention of possession by the pledgee himself or by the pledgee's agent is not essential to the continuance of the life of such right. The possession may be transferred to (a) a bailee of the pledgee, or (b) to a second pledgee by a repledge, or (c) to a purchaser. This was the thought of Mr. Justice Jackson in *Jarvis v. Rogers* (p. 193), it was confirmed by Story (p. 194), and it has been unquestioned law in this country for over a century.

2. This quality of assignability is not restricted to pledges which are securities for debts evidenced by negotiable instruments. *All* pledges are assignable. Now, the courts are unanimous in saying that debt and security must never be separated. Therefore, if the traditional view that a debt not evidenced by a negotiable instrument is not assignable at law is supported, three statements are made: (1) A pledge interest is always assignable; (2) a debt not evidenced by a negotiable instrument is not assignable; and (3) security and debt may never be separated. All three of these statements *cannot* be true. Which is not true? The *second* statement. But, if our conclusion in Chapter IV (pp. 35–107) is sound, and second-class and third-class debts *are* assignable at law before default, then the law becomes simple and harmonious.

3. According to Lord Ellenborough, a lien was "practically"

assignable (p. 191). The intended assignee might hold as the "servant" of the intended assignor, but for the benefit of himself, the "servant." What the law on this is today we do not know, but we can see no justification for making such heavy weather of it. We think that even a mere lien is a right *in rem*, and that there is no good reason why it should not be assignable (see p. 16).

4. A delivery by a pledgee pursuant to an unauthorized sale intended as a liquidating sale is a conversion. It is the delivery, the tortious transfer, not the sale, which is the act constituting the conversion. *All* such deliveries are conversions; we know of no exception to that rule. (*Cf.* p. 138, note 37.) Good faith and due care on the part of the pledgee do not save him from being a converter. There may be liability without fault.

5. In the old law, the conversion forfeited the right *in rem* of the pledgee, although not the debt, his right *in personam*. The creditor was still a creditor, *but* by the forfeiture he was turned from a *secured* creditor into an *unsecured* creditor.

6. If the debtor were solvent, this forfeiture did not matter. B was liable in conversion, but A was liable in contract and was good for one hundred per cent of the judgment in an action of contract. Crisscross saved the creditor from loss. *But* if the debtor were insolvent, forfeiture of the right *in rem* was a very serious matter for the creditor.

7. One important feature of the modern law of pledge is that, although the first decision did not come until 1863 (p. 196), it is clear law today that, at least as a general rule, the conversion occurring through a delivery made pursuant to an unauthorized sale intended as a liquidating sale does not work a forfeiture of the right *in rem*.

8. Possibly, there may be an exception to this general rule if the sale was not conducted fairly. We think that even in such case there should be no exception. It is so easy to make charges of unfairness, and juries sometimes do go astray. We think that a doctrine of forfeiture if a jury makes a sustainable finding of unfairness would so tend to chill loaning at lower rates on security that for reasons of public policy there should be no forfeiture. Do

not forget two facts. The first is that no question arises unless A defaults. The second is that the risk of having a jury make a sustainable finding that the fair market value of the property sold was in excess of the proceeds actually received is a *substantial* check upon unauthorized sales intended to be liquidating sales.

9. It is important to note that the *Dimock* rule (p. 200) gives an option to sue for a conversion *or* for a breach of contract on tender, demand and refusal on the facts of that case.

10. Points 4 to 9, both inclusive, relate to A, B cases. The parties are A the debtor, and B the creditor who has converted the security. Do not confuse A, B cases with A, C cases. A, C cases are those in which B has tortiously assigned the pledge to C, a bona fide purchaser or pledgee.

11. *Donald v. Suckling* (p. 204) is authority that if B pledges to C for a greater amount than A owes B, the right *in rem* of the pledgee is *not* annihilated. A cannot maintain detinue without making a tender of the amount due from A to B (this amount is not to be confused with the amount due from B to C).

12. The *Talty* case (p. 207) goes even further, for there B assumed to make an outright sale to C. We are not confident that this will be followed in England, but are confident that it will be followed in this country.

Note that this chapter is devoted to *second-class* securities. If the securities are first-class, C is protected in cases like 11 and 12 by the *nature of the security.* He gets independent rights, and not merely derivative rights. He gets what he thinks he is getting (p. 22). He therefore does not need the benefit of the no-forfeiture doctrine which is the characteristic doctrine of the *modern* law of pledge as compared with the pre-1863 law.

Chapter VIII

TORTIOUS TRANSFERS OF FIRST-CLASS SECURITIES

Herein of *Wood v. Fisk*

BEFORE making the direct assault upon that citadel of mischief, *Wood v. Fisk* (which we have been steadily investing in prior chapters), it is necessary to discuss at some length a bankruptcy decision in 1904 by the Supreme Court of the United States, — *Crawford v. Burke*.[1]

Bankruptcy statutes have had, and now have, three objectives. First, in the interest of all creditors, it is desirable that the control over assets of a person who has ceased to be able to meet his obligations should be taken from him and vested in a representative of his creditors. Second, it is desirable to eliminate preferences whereby some creditors gain an undue advantage over other creditors, — secured creditors are entitled to the benefit of the securities with which they have been so prudent as to buttress themselves, but all unsecured creditors should obtain a uniform percentage upon their claims. Third, it is desirable that honest men who have come to grief should be given a fresh start, by wiping the legal (not the moral) slate clean of unfulfilled obligations, and should thereby be encouraged to become useful economic units.

If one studies the various bankruptcy and insolvency statutes which have been passed, one is impressed by the increase of emphasis which legislatures have laid upon this third objective, — the " fresh-start " objective. And we submit that wise public policy requires that great emphasis should be laid upon this objective; no doubt this policy has its dangers, but we believe that, on balance, the advantages definitely outweigh the disadvantages.

Assume that the " fresh-start " objective is regarded by a legislature as desirable. Then the simple way to reach it would be to provide that the discharge shall be a bar to the assertion of *all* claims (tort or contract), with such exceptions as the legislature

[1] 195 U. S. 176, 49 L. Ed. 147, 25 Sup. Ct. 9 (1904).

sees fit to specify. The legislature will probably except some wrongs which would be popularly characterized as outrageous wrongs (and in such case will allow the claimant to prove, receive his dividend, apply that on account and sue for the balance if he thinks that the bankrupt has subsequently acquired enough assets to make the suit worth while).

It is matter of regret that the statutes have not been on that simple model. Instead, the statutes have presented problems of construction which have often been very difficult to solve. Draftsmanship has been low-grade. The Bankruptcy Act of 1898 may be criticized on that ground.

In *Crawford v. Burke,* A was a margin customer and B the stockbroker. B tortiously sold and delivered shares of stock owned by A, and held by B as a security for the amount due from A to B, and appropriated the whole of the proceeds to his own use. Moreover, B thereafter tricked A; he claimed that he was holding the shares and called for more margin and A met the calls.

B filed a petition in bankruptcy. A filed no claim in the bankruptcy proceedings, but brought an action in tort against B to recover (1) for the conversion of his pledgor's interest in the shares, and (2) for the amount paid in as margins after B had sold. B obtained a discharge in bankruptcy and pleaded it. The issue was whether or no the discharge was a bar.

The Bankruptcy Act of 1898 had a "fresh-start" policy, but the scope of such policy was limited in two ways. In the first place, the discharge was not a bar against *any* claim unless such claim was a "provable debt," as defined in Section 63. In the second place the discharge was not a bar against certain exceptional "provable debts," the exceptional cases being defined in Section 17.

The court first considered Section 17, which provided: "A discharge in bankruptcy shall release the bankrupt from all of his provable debts except such as . . . (2) are judgments in actions for frauds, or obtaining property by false pretences, or false representations, or for willful and malicious injuries to the property or person of another . . . or (4) were created by his

fraud, embezzlement, misappropriation, or defalcation while acting as an officer, or in any fiduciary capacity."

Had B been acting in "a fiduciary capacity"? The court carefully considered this, but concluded that Congress had not intended that the phrase should be given such a large scope as to cover stockbrokers acting for margin customers, *contrasting* them to trustees, executors, administrators, guardians, and the like.

The discharge was, therefore, not within any exception in Section 17. But was there not a more fundamental difficulty? Was the claim of A a "provable debt" within the meaning of Section 63? Was any claim based on tort and not reduced to judgment a provable debt?

The court said that Section 63 must be read in connection with Section 17, in which the provable character of claims for fraud in general was recognized. The full text of Section 63 is given in the margin, but the only provision pertinent to our discussion is subdivision 4, debts "founded upon an open account, or upon a contract express or implied."[2]

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[2] "Debts which may be Proved. — (a) Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date, or with a rebate of interest upon such as were not then payable and did not bear interest; (2) due as costs taxable against an involuntary bankrupt, who was at the time of the filing of the petition against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines to prosecute after notice; (3) founded upon a claim for taxable costs incurred in good faith by a creditor before the filing of the petition in an action to recover a provable debt; (4) founded upon an open account, or upon a contract express or implied; and (5) founded upon provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interests accrued after the filing of the petition and up to the time of the entry of such judgments.

(b) Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against his estate."

We submit that (5) does not extend the scope of "provable debts," but only provides a method of liquidation as an alternative to the method provided by Section 63b. (2) and (3) are of relatively little importance. Therefore at this time the only important species of provable debts were those specified in (1) and (4). Note that in the expression "provable debt," the word "debt" is used as though it were synonymous with "claim."

With respect to such a "provable debt" we quote in full everything which the court said. At page 187, it said: "We are clear that the debt of the plaintiff was embraced within the provision of paragraph *a*, as one 'founded upon an open account, or upon a contract, express or implied,' and might have been proved under section 63a had plaintiff chosen to waive the tort, and take his place with the other creditors of the estate. He did not elect to do this, however, but brought an action of trover, setting up a fraudulent conversion of his property by defendants. In the first five counts of his declaration he charges a fraudulent conversion of his interest in the stock, and in the last five counts that the defendants had induced him to make further payments on such stock in the way of margins, by false and fraudulent representations."

After its discussion of Section 17 it came back to Section 63 and said: "But it is strenuously insisted by the plaintiff that a claim for the conversion of personal property is not within the scope of section 17; because it is not a 'provable debt' within the definition of section 63a. Did the latter section stand alone, there would be some ground for saying that a claim, though 'founded upon an open account, or upon a contract, express or implied,' would not be a provable debt, if plaintiff elected to treat the conversion as fraudulent and sue in trover, though he might have chosen to waive the tort and bring an action for a balance due on account. An early English case, *Parker v. Crole,* 5 Bingham, 63, is cited to the effect that the operation of the discharge is determined by the election of the creditor to sue in assumpsit or case. A like ruling was made in certain cases under the bankruptcy acts of 1841 and 1867. *Williamson v. Dickens,* 27 N. Car. 259; *Oliver v. Hughes,* 8 Pa. St. 426; *Bradner v. Strang,* 89 N. Y. 299, 307.

"But we think that section 63a, defining provable debts, must be read in connection with section 17, limiting the operation of discharges, in which the provable character of claims for fraud in general is recognized, by excepting from a discharge claims for frauds which have been reduced to judgment, or which were committed by the bankrupt while acting as an officer, or in a fiduciary capacity. If no fraud could be made the basis of a

provable debt, why were *certain* frauds excepted from the operation of a discharge? We are, therefore, of opinion that if a debt originates or is 'founded upon an open account or upon a contract, express or implied,' it is provable against the bankrupt's estate, though the creditor may elect to bring his action in trover as for a fraudulent conversion, instead of in assumpsit for a balance due upon an open account. It certainly could not have been the intention of Congress to extend the operation of the discharge under section 17 to debts that were not provable under section 63a. It results from the construction we have given the latter section that all debts originating upon an open account or upon a contract, express or implied, are provable, though plaintiff elect to bring his action for fraud.

"In the case under consideration defendants purchased, under the instructions of the plaintiff, certain stocks and opened an account with him, charging him with commission and interest, and crediting him with amounts received as margins. Subsequently, and without the knowledge of the plaintiff, they sold these stocks, and thereby converted them to their own use. Without going into the details of the facts, it is evident that the plaintiff might have sued them in an action on contract, charging them with the money advanced and with the value of the stock; or in an action of trover based upon their conversion. For reasons above given, we do not think that his election to sue in tort deprived his debt of its provable character, and that as there is no evidence that the frauds perpetrated by the defendants were committed by them in an official or fiduciary capacity, plaintiff's claim against them was discharged by the proceedings in bankruptcy."

Comment:

1. We have heard this opinion adversely criticized, but we see no justification for such criticism. The draftsmanship of the Bankruptcy Act of 1889 was low-grade, but that was the fault of Congress, not of the Supreme Court. The court scrupulously abstained from drafting a better act under the guise of construction; it construed the act so as to give some intelligible significance to every provision, and it resolved doubts by giving effect to the

legislature's general intent to give a fairly broad scope to the "fresh-start" policy.

2. The case decided that when a stockbroker opens an account with a margin customer, holding the shares purchased as security for the customer's debt, charging him with commission and interest, and crediting him with margin payments and income received, any claim which the customer has against the stockbroker by reason of any improper conduct relating to that account is a "provable debt," because it is founded upon "an open account."

3. May the customer file his claim in tort if he so wishes? In *Schall v. Camors*,[3] bankrupts had defrauded claimants by selling them worthless commercial paper. The wrongful act was a tort and nothing but a tort. The court said (p. 251): "We are clear that claims based upon a mere tort are not provable. Where the tortious act constitutes at the same time a breach of contract a *different* (italics supplied) question may be raised, with which we have no present concern; and where, by means of the tort, the tort-feasor obtains something of value for which an equivalent price ought to be paid, even if the tort as such be forgiven, there may be a provable claim *quasi ex contractu*."

There are those who, relying on this case, contend that no claim grounded on a tort is provable unless reduced to a judgment. But we believe that the law as to the provability of a claim grounded on a tort, *not* reduced to judgment, is as follows:

If the wrongful act was a tort, but *not* also a breach of contract, the claim is not provable. And even if the wrongdoer obtains value through the tort so that the claimant might sue in indebitatus assumpsit (or its modern equivalent), the claimant if he proves must ground his claim on the promise which the law implies in such case, and *not* on the tort.

But if the wrongful act was a double-aspect act (*both* a breach of contract and a tort) the wronged party had, before bankruptcy intervened, an option to sue in contract or in tort. Now, the court might conceivably have held that, when bankruptcy intervened, this option was lost, and that the claimant must prove

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[3] 251 U. S. 239, 64 L. Ed. 247, 40 Sup. Ct. 135 (1920). See also *Stalick v. Slack*, 269 F. 123 (1920).

in contract. But that is precisely what the court in *Crawford v. Burke* did *not* do. No. Bankruptcy did not destroy the option. The claimant might prove either way he wished (and this *might* be important, for "involuntary-purchase" damages might be greater than "compensatory" damages; see our pp. 139–147). Moreover, even if the claimant brought suit in tort and thereby made a conclusive election to go the tort road rather than the contract road (so that now the tort has no longer a contract running mate), that is all right. He may prove his claim in tort. In such cases therefore a claim grounded on a tort *is* provable, although not reduced to judgment.

That is the conclusion which the Supreme Court reached in its carefully reasoned opinion in *Crawford v. Burke,* and we see nothing in any subsequent opinion which modifies that conclusion. In *Schall v. Camors* (p. 219) the court was careful expressly to say that if the wrong was both a breach of contract and a tort, that was a "different" matter.

This is of the first importance. For all tortious transfers by pledgees are *both* conversions and breaches of contract, express or implied.

Note that subdivision 4 of Section 63 speaks of claims founded upon an open account *or* upon a contract express or implied. The court rested its decision on the open account. It did *not* rest its decision on the "contract express or implied" alternative. The claimant had a provable claim grounded on a *tort,* which had been committed by the stockbroker on a matter where there was *an open account* with the margin customer.

We pass to *Douglas v. Carpenter.*[4] The action was brought by B (members of the New York Stock Exchange) to recover from A, a margin customer, the balance due. A made a counterclaim for a conversion by B. The court stated the question as follows: Were the plaintiffs guilty of a conversion of the defendant's securities by pledging them for the benefit of the plaintiffs' own business, mingling them with other securities, and obtaining loans thereon for a greater amount than the indebtedness of the de-

[4] 17 N. Y. App. Div. 329, 45 N. Y. Supp. 219 (1897).

fendant to the plaintiffs on account thereof, and *without* retaining in the plaintiffs' possession other securities of a like kind and amount?

A had offered to prove that B had done this, and the referee had rejected the evidence. The court held this to be error, reversed a judgment for B against A, and ordered a new trial.

It recognized that B was not required to keep the identical securities purchased, provided he at all times kept in his possession, or under his control, securities of like kind and amount. It also recognized that B might lawfully have pledged A's securities by themselves, separate and apart from others, for an amount not exceeding A's debt to B (this is the principle announced by Mr. Justice Jackson in *Jarvis v. Rogers* and confirmed by Mr. Justice Story. See our pp. 193–196).

But it pointed out that C, to whom B pledged the securities, would have independent rights under the principle of what we have called possession, *plus* (p. 22; certificates of stock indorsed in blank were not made negotiable instruments by statute in New York until 1926), and said: "It will not do to say that plaintiffs *might* be able to get defendant's securities released from the pledges made by them, by paying up the whole or a part of the amount for which the pledges were made, and so be able to surrender them to defendant on payment or tender of the amount of his indebtedness. His doing this, like his purchasing other securities in the case of a sale or loan already referred to, would be dependent upon his having the funds to pay the amounts for which the pledges had been made or upon his ability to get such securities released, and the same reasoning is applicable to pledges as would apply to sales or loans under like circumstances."

It also expressed the same thought in another place in the opinion in these words: "It would not do to say that the plaintiffs *might* go into the market and buy other securities of a like kind and amount on payment or tender being made by defendant, because the plaintiffs might not have the funds to purchase the new securities, and *the only reliance the defendant would have would be the personal financial responsibility and ability of the plaintiffs, whereas he had a right to rely upon the securities them-*

selves, and if they were retained he could get them, whether the plaintiffs were financially responsible or not.

"As said by Rapallo, J., in *Taussig v. Hart, supra,* 'To allow a broker to sell his customer's stock without authority, and speculate upon replacing it at a lower price, would be encouraging speculations by agents at the risk of their principals, totally inadmissible under familiar rules. Should the stock rise largely in price after the broker had thus divested himself of all control over the shares which he had purchased on the order of his principal, the broker might be unable to replace the shares, and *the principal would have no remedy except a personal claim against the broker. This* clearly is not what is contemplated under an agreement to buy *and carry* stocks. The customer does not rely upon an engagement of the broker to procure and furnish the shares when required, but upon his actually purchasing *and holding* the number of shares ordered, *subject only to the payment of the purchase price.*'"

It also said: "There are some things about which there is *no dispute. The relations of pledgor and pledgee* existed between [A] and [B]. The securities were the property of [A] and [B] had a lien (as to the use of this chameleon-like word see our p. 12) thereon for the amount of their advances. The unauthorized sale of the securities by [B] would have been a *conversion* thereof. An unauthorized loan of the securities by [B], with the understanding that the persons borrowing them might sell or dispose of them according to their pleasure, would have been a *conversion* thereof. Such sale *or* loan would not have been consistent with the general ownership and ultimate rights of [A]. *No custom,* however general or long continued, could make such sale *or* loan legal, because it would be inconsistent with the contract between the parties and in derogation of the property rights of [A]. [A] had the ownership of the securities, but not the right of possession. His interest in the property consisted in his right of redemption. By payment or tender of the indebtedness the lien (our p. 17) of [B] would have been discharged, and [A] would have become entitled to the immediate restoration of his property. [B] might take title to the securities in [his] own name, and [was] not

bound to retain or deliver the identical securities purchased for [A]. [His] duty was to keep on hand, or under [his] control, either the securities of [A] or a like kind and amount of securities, and to have them in such situation that [A], by paying the amount due by him thereon, could, at any time, obtain them. This was what [B] agreed to do, and so long as [he] did this, the fact that [he] used the securities while in [his] possession, awaiting redemption by [A], would not amount to a conversion thereof. These principles are well settled and are recognized by both parties." (Italics supplied in preceding four paragraphs.)

In 1900 the author became a law clerk in New York City, and for some time devilled for Mr. John L. Cadwalader, Mr. George W. Wickersham and Mr. Henry W. Taft. All three men had both ideals and *also* the realistic approach to the task of implementing these ideals as a practical matter; they were insistent, with a Spartan insistence, upon absolute accuracy down to the minutest detail in getting at the facts which it was necessary to have in mind as a basis for a wise exercise of judgment. The firm numbered among its clients banking houses and stockbrokerage firms, and the author gained information as to the conduct of the brokerage business and the pertinent New York law.

At that time there was a great deal of speculation in stocks, and there was a legion of margin customers. Many reputable brokerage houses were prepared to do business on a 10 per cent margin. Many banks would lend to reputable brokers on approved security up to $83\frac{1}{3}$ per cent of market price ($1,000 loaned on $1,200 market price). If the market fell, the banks would call for additional security or a payment in reduction of the loan, and at the same time the stockbroker would be making like calls upon his customers. If the stockbroker failed to keep his $16\frac{2}{3}$ per cent margin good, the bank lawfully might make, and usually did make, forthwith a liquidating sale (p. 188), and the customer found himself out on the sidewalk with nothing but a right *in personam* against a broken broker. A particular customer might have kept up his margin with his broker, but, despite that, his title was swept away. The sins of the stockbrokers were visited upon the customers. This consequence necessarily follows

if the bank has rights which are *independent* and not merely *derivative* (p. 22).

Every time, therefore, that a stockbroker pledged the securities of a customer to a bank for an amount larger than the debt of the customer to the stockbroker (and usually the amount of the B, C debt was a great deal larger than the amount of the A, B debt), the customer's title was put in jeopardy of a destruction consequent upon a default, not by himself, but by the stockbroker. We submit that it is plainly improper for a stockbroker to make a pledge, putting his customer's title in such jeopardy, *unless* the customer gives a conscious, intelligent consent.

Since in a typical case as business was then conducted (compare the present situation, stated at p. 363), the bank supplied $83\frac{1}{3}$ per cent of the wherewithal, the customer 10 per cent and the stockbroker $6\frac{2}{3}$ per cent, and since banks were definitely unwilling to make a multitude of small loans to stockbrokers limited in each case to the amount due from the particular customer, it inevitably followed that, as a practical matter, stockbrokers either must pledge their customers' securities as collateral for loans greatly exceeding in amount the debt due from any particular customer, or else close their doors and retire from the stockbrokerage business.

Grasp the business situation. Do not seek to smother or evade the difficulties. As a practical matter, repledges by stockbrokers to banks of customers' securities are regarded at the present time as *a business necessity* by most, if not all, stockbrokers.

The question therefore narrows to this: Shall stockbrokers be required to open the eyes of their customers to the very serious risk that they will run, and obtain consent — a *conscious, intelligent* consent — to exposure to such a risk?

Obviously, opening the eyes of customers to such a risk is bad — very bad — for the stockbrokerage business. It chills prospective customers if they realize (as many of them seem even yet not to do) that, when they take a flier, there is the *double* risk (1) that the particular stock may fall, *and also* (2) that the stockbroker may break. Therefore, many (not all) stockbrokers have

been vocal for "the custom of the street." The argument was that such repledges were a business necessity. "Everybody was doing it." It was a custom of the street and had been a custom of the street throughout financial memory. Therefore, it was strenuously contended, it was legal, all theorists to the contrary nothwithstanding.

Douglas v. Carpenter was decided in 1897. It was emphatic against the "custom of the street." We have extolled Mansfield and his inclination to confirm the usages of business men (p. 91). But he was far too wise a person ever to give sanction to any doctrine that *all* such usages were to be confirmed. There might be some good reason to the contrary. The business usage raised a prima facie case, but a prima facie case *only*. In *Douglas v. Carpenter* for the reasons there stated the court refused — and unequivocally refused — to confirm this "custom of the street." There were good reasons which blocked confirmation.

This met with a mixed reception in New York City. The idea was not popular with most stockbrokers. The author at that time was not infrequently in the company of some stockbrokers whose habit of life was to be charming, confident, and convincing, and their arguments made an impression upon him.

The doctrine was not approved by some lawyers, but it was approved by some. The author never heard Mr. Cadwalader speak of it (for the work under him was mostly on property questions arising from family settlements), but both Mr. Wickersham and Mr. Taft believed in it, and (possibly by reason of his great respect for the soundness of their opinions) the author after some hesitation came to believe in it. The experience of subsequent years has strengthened — and greatly strengthened — that belief.

It is interesting to note that the counsel for the customer in *Douglas v. Carpenter* was Benjamin N. Cardozo, Esquire.

This brings us to our *pièce de résistance.*

Wood v. Fisk.[5] A was a customer of B, stockbrokers in the city of New York. B loaned A $39,000, and received A's promissory

[5] 215 N. Y. 233, 109 N. E. 177 (1915).

note with certificates for certain shares of stock indorsed in blank as security therefor. The note expressly provided that B might repledge the security for an amount *not* exceeding A's debt to B. But, nevertheless, B repledged for a larger amount. The certificates were mingled with a mass of others and pledged to C, a bank, as part of the collateral for a loan exceeding in amount A's debt to B. This was done without the consent or knowledge of A, and without B's retaining in his possession or under his control similar certificates of like amount.

Thereafter, on February 1, 1910, an involuntary petition in bankruptcy was filed against B, and a receiver was appointed. On March 1, 1910, B was adjudicated bankrupt. On March 21, 1910, A's note matured. A then made to B a conditional tender of the amount due, the condition being that the security be returned, and demanded from B the return of the security. B said that the security was not in his possession and could not be returned. As matter of fact, B had already defaulted to C, and C had made a lawful liquidating sale (see our pp. 188–190) so that A's title had been swept away.

A then sued for conversion and built "his cause of action on the failure to return the collateral after the tender of the debt." B meanwhile had received a discharge in bankruptcy, and this discharge was pleaded in bar.

The court in an opinion by Judge Cardozo, as he then was (he was later Chief Judge of the New York Court of Appeals, and, still later, an associate Justice of the Supreme Court of the United States), after reciting these facts, said that A's replication to the plea was "that his cause of action was not provable in bankruptcy; that it did not arise until tender and refusal; and that till then, it was contingent and unprovable. He disclaims any purpose *to rely on the repledge of the securities as making out a conversion.* To give his right of action that basis, would be to trace its origin to a date anterior to the bankruptcy. He elects, therefore, *to rely on the demand and the refusal,* and viewing them as isolated acts, he argues that at the hour of bankruptcy, the debt was not in being." (Italics supplied.)

The court then said: "Whatever [A's] election or desire may

be, his cause of action for *conversion, if it is to be sustained at all,* must go back, we think, to *the wrong involved in the repledge* of the collateral. The note was an asset of the estate; the shares of stock were collateral to the note; the receiver had the right to hold them; and from the moment of bankruptcy, the note and any collateral accompanying it were in the custody of the law. Take out of the case the element of the repledge, and there has been no conversion at all. Let us suppose, for illustration, that the securities had never been repledged, but were still intact. Let us suppose that they had been earmarked, and turned over to the receiver. Obviously, the failure of a bankrupt in such circumstances to surrender them to a customer, would not constitute a wrong. They had been taken from him and impounded by the act of the law itself. The tender, indeed, in the case supposed, if it was made to the bankrupt, was not even made to the right person. It ought to have been made to the receiver. The note, after the bankruptcy, was payable to the receiver, and the right to collect it was given to no one else. It is impossible, therefore, to shut our eyes to the events before the bankruptcy, and to concentrate our attention on the events that followed. *It is only because of the earlier events that* [*A*] *can prove that he has been wronged.* His cause of action does *not* grow out of the fact that the tender was rejected. *It grows out of the fact that the shares were repledged. The subsequent refusal is merely evidence of the extent and measure of the loss.*

"We go back, then, to *the repledge of the securities as the origin of the wrong,* and going back to that act, we find that at the filing of the petition, [A] held a claim that was provable in bankruptcy. It was a claim 'founded . . . upon a *contract* express or implied' (Bankruptcy Act, section 63a, subd. 4; *Crawford v. Burke,* 195 U. S. 176). The repledge of the collateral for more than [A's] indebtedness was a wrong both by force of general rules of law, and in this case by force of the express restrictions of the note. It *may have* constituted a *conversion* (*Douglas v. Carpenter,* 17 App. Div. 329; *Mayer v. Monzo,* 151 App. Div. 866). It was *unquestionably a breach of contract* (*Donald v. Suckling,* L. R. [1 Q. B.] 585; *N. Y., L. E. & W. R. R. Co. v. Davies,* 38 Hun,

477, 480). *There are times, it is true, when a repledge, though illegal, will expose the broker to a liability for nominal damages and no more. This is so where the securities are redeemed and restored to the customer upon demand* (*Donald v. Suckling, supra*). A repledge, unlike a sale, does not involve an absolute repudiation of the title of the primary pledgor; the conversion, if we view the transaction as a tort, is an assumption of partial rather than complete dominion; and the return of the subject of the pledge is, therefore, provable in mitigation of the damages (authorities cited). But if, as a result of the repledge, the securities are put in a position where they cannot be returned upon demand after tender by the customer of the balance due upon them, then the value of the customer's equity in the securities is the measure of his loss. In either case, however, the repledge remains a wrongful act, whether the damages recoverable are *nominal* or substantial. *The tender and refusal do not constitute the wrong. They are evidence of the extent of damage resulting from the wrong.* They show that the consequence of the repledge has been to disable the pledgee from restoring the thing bailed (authorities). The cause of action was thus complete at the moment of the bankruptcy; it had its origin in a *breach of contract* (*Crawford v. Burke, supra*); and it did not cease to be provable, because the damages were then unliquidated (Bankruptcy Act, section 63b; *Williams v. U. S. F. & G. Co.*, 236 U. S. 549, 556)." (Italics supplied.)

The court also said: " [A] makes the additional point that even though his claim was provable, it was excepted from the operation of the discharge. He argues that it was, within the meaning of section 17 of the Bankruptcy Act, a liability for 'willful and malicious injuries to the property of another.' We held in *Kavanaugh v. McIntyre* (128 App. Div. 722; 210 N. Y. 175), and again in *Andrews v. Dresser* (214 N. Y. 671), that there may be acts of *conversion* so wanton as to be included in that exception. Those were cases where the charge of conversion was equivalent to a charge of larceny. We think the misuse of [A's] securities is not to be classified as a willful and malicious injury within the meaning of that statute (*Johnston v. Bruckheimer*, 133 App. Div.

649; *Allen v. Fromme,* 195 N. Y. 404, 407) . . . the repledge, unlike a sale, left the general property in [A]; it gave rise, until followed by bankruptcy, to *nominal damages* only; and so far as there was any willful *conversion,* it was, therefore, partial and *technical* rather than absolute and malicious. Whether this would be true to-day, since the enactment of recent statutes under which the wrongful repledge of securities by stockbrokers is made a felony (Penal Law, section 956; L. 1913, ch. 500), we do not now decide. The rights of the parties must be adjudged according to the law as it stood when the wrong was done." (Italics supplied.)

Comment:

We adversely criticize this opinion for the following seventeen reasons:

Criticism Number 1.

It tends to undermine the fundamental of fundamentals, which is that margin customers have *property* rights, rights *in rem,* and not merely contract rights, rights *in personam.*

No law on this topic fit to endure can be built except upon that rock-bottom foundation. Let the wise take warning from some consequences of the opposite view, as shown by Massachusetts cases of which we shall speak in Chapter X.

In the next chapter we trace the New York law in detail. At the moment, we will ask the reader to take our word for it that the question whether margin customers did, or did not, have anything more than contractual rights had been twice before the Court of Appeals, and that after elaborate argument by eminent counsel and prolonged consideration by the court, the court had decided by decisive majorities (6 to 2 and 5 to 2) that the customer did have more than contractual rights. That excellent judge, Judge Rapallo, although originally a breach-of-contract man, thought it seemly after the second decision to acquiesce in the property doctrine, and no judge had, for decades before *Wood v. Fisk* was decided, challenged the property doctrine either directly or indirectly. Everybody supposed the property doctrine was clear, well-settled law.

It is true that Judge Cardozo made no frontal attack upon that

doctrine. But his opinion unquestionably tends to undermine that doctrine. There had been a tortious repledge. *If* the property doctrine is applied, such tortious repledge was a conversion by B, the pledgee.

Was it a conversion? "It may have been a conversion; it was unquestionably a breach of contract." If the property doctrine is applied, there is no justification for that "may have been" (see further on this, criticisms 7, 8, and 9). Of all the mischievous words of juristic tongue or pen, the worst were these "may have been."

There is a temple dedicated to the worship of a Janus-faced God. The left-side face is a conversion face; the right-side face is a breach-of-contract face. The ritual for worship in that temple is to advance to the altar, and to make obeisance to the left side face, saying "Maybe"; and then to make a deeper obeisance to the right side face, saying "Unquestionably."

Let no believer in the true faith of the customer's *property* rights so much as cross the threshold of that temple.

Criticism Number 2.

Judge Cardozo did not mention three pertinent decisions in the Court of Appeals on the vital question whether a tortious pledge *was* a conversion. The opinion creates the impression that whether a tortious pledge was or was not a conversion was a very doubtful matter upon which the Court of Appeals had given no lead, that the only answers had been given by the Appellate Division, and that in the Appellate Division there were only two cases (*Douglas v. Carpenter* and *Mayer v. Monzo*) one saying "Yes," and one saying "No."

But a search of the authorities shows that there were three other cases in the Appellate Division which answered "Yes," and, what is more important, and vastly more important, that the Court of Appeals itself had proceeded on the conception that a tortious repledge *was* a conversion not less than three times. *Hennequin v. Clews* (p. 279), *Capron v. Thompson* (p. 281), *Farwell v. Importers' Bank* (p. 282).

There was not a word about any of these cases in Judge Car-

dozo's opinion. Was he ignorant of them, or did he just ignore them?

Criticism Number 3.

Judge Cardozo's opinion blurred the line between *meum* and *tuum*.

If a trustee, executor, administrator, or guardian uses funds which are under his control in his capacity as a fiduciary, he incurs not only a civil but also a criminal liability. Restoration of the *status quo ante* does *not* wipe out such liability, — not even the criminal liability.

There is, no doubt, a line between such a case and the case of a stockbroker who for the purpose of carrying on his stockbrokerage business tortiously pledges his customers' securities. Legislatures have seen fit to draw a line for *some* purposes between stockbrokers and "fiduciaries" in the strictest meaning of that term. But, we submit, the difference is one of degree, not of kind. It is not fitting that "Sing Sing" should await the trustee who uses trust funds for his own purposes, and that nothing but "Tut, tut" should await the stockbroker who uses his customers' property for his own purposes (*if* thereafter by good luck it "comes out all right").

Judge Cardozo — quite unwittingly and unintentionally — rendered an opinion which inevitably tended to weaken civil deterrents on the use by stockbrokers for their own purposes of property which belongs to their customers. That a man of such unquestioned and unquestionable integrity should have failed to see the probable consequences of his opinion amazes us (no word milder than "amazes" is adequate).

Grasp the danger. Realize that there ought to be civil deterrents upon acts by stockbrokers which put their customers in *jeopardy of a total loss of their property through no default of their own*. Is there not as much need of civil deterrents against that as there is need of civil deterrents against the use by banks (which have made loans on security) of the security of their customers for the purpose of getting funds to carry on the banking business?

Criticism Number 4.

The opinion played right into the hands of the old custom-of-the-street Guard.

The New York courts had given the country a wise lead not only by holding that the broker was not the owner but only a pledgee, but also by holding that he stood before the common law *like any other pledgee.* The New York courts had been adamant against any (financial) *imperium in* (the common law) *imperio.* Brokers could not hedge themselves with immunity behind customs-of-the-street which contravened the rules of the common law, *unless* they obtained from their customers a conscious, intelligent consent to their being relieved in part of their common law duties. *They must learn to look horizontally at other pledgees.* (We shall see later that a Massachusetts judge said that stockbrokers are not " ordinary " pledgees.)

One of the customs-of-the-street was to repledge the securities of their customers to secure bank loans. " It is a business necessity; everybody is doing it." But the court had said " No; that just *must* not be done," and had never deviated from that flat negative.

Now comes the opinion in *Wood v. Fisk.* A shrug of the shoulders, a lifting of the eyebrows, a murmur about a " technicality." " Of course, you really ought not to do it, but we are broad-minded. We realize that it will be highly convenient for you to do it, and that, if you do it, it will *probably* come out all right. All we ask is that you remember that if it does come out all right, you will have to pay six cents. Be sure that you have six cents, but, if you have that amount, do not be unduly disturbed."

Is not that an encouragement to do, on this matter, precisely what the custom-of-the-street Guard always contended that it was lawful for brokers to do? Is this not, although no frontal attack, an insidious undermining?

Until the *Wood v. Fisk* opinion, custom-of-the-street had been as dead as Jim Fisk. But came that opinion, and, in the twinkling of a business eye, the old custom-of-the-street Guard became the new Cardozo Guard.

The credulous believe that, on the night after the day when the decision in *Wood v. Fisk* was handed down, Jim Fisk walked.

Criticism Number 5.

Judge Cardozo sanctioned the idea that a conversion may be merely " technical."

This is flatly contradictory to one of the most elementary principles in the law of conversion.

In Chapter V, the foundation chapter on Trover and Conversion, we saw that not every tortious intermeddling is a conversion, that it is only *major* torts which are conversions (p. 117). It is only major torts that have the involuntary-purchase consequence.

In fairness to Judge Cardozo, it should be pointed out that he was not the first judge to use this expression. Time was when *any* conscious misuse by a bailee was a conversion. Thus, if B hired a horse from A to ride from X to Y and back, and B, on arriving at Y, pushed on to Z, he was a converter. Later, courts came to regard it as unfitting that B should, because of such a trifling wrong, be made an involuntary purchaser of the chattel. Some of the judges frankly said that the old law was too severe, and mellowed the law. But others — more's the pity — reached the new result, but could not bring themselves to say that it was *not* a conversion. They got astride the well-known fence, and said that the wrong by B was a conversion (old law) but that it was only a " technical " conversion (new result).

But there is no justification whatever for the use of such an expression. That kind of tort to property which is a mere trifling wrong is *not* a conversion. A trifling major tort is a contradiction in terms. As well speak of a one-inch giant.

It may be urged that he was not using " technical " conversion to indicate a tort for which only nominal damages were appropriate, but only to indicate a conversion which was committed unwittingly, — by a blunderer with a white soul. He did so use the expression in *Davis v. Aetna Acceptance Co.*[6] where he said: " There may be a conversion which is innocent or technical, an unauthorized assumption of dominion without willfulness or malice." But note that in *Wood v. Fisk* the defendant had violated the *express* terms of the pledge. How could such an act fairly be characterized as " without willfulness "?

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6 293 U. S. 328, 332, 79 L. Ed. 393, 55 Sup. Ct. 151 (1934).

It is difficult to say just what that expression "technical conversion" did mean to Judge Cardozo.

Thus in *Mutual Trust Co. v. Merchants National Bank*[7] he used it in a very different sense from the *Wood v. Fisk* sense. A owned stock, and it was pledged to B. The officers of A wanted to get the stock back in order to deceive a bank examiner. These officers redeemed the stock from B, and the transaction involved giving B a check of A for $90,000. A was later put in charge of a liquidator by the state banking commissioner, and the liquidator sued B for conversion of the $90,000 check.

The court, speaking by Judge Cardozo, held that B did no wrong in accepting the check unless it had notice, either actual or sufficient to put it upon inquiry, and held that, although A's officers were without power to issue the corporate check for the redemption of the stock, B had no such notice.

"We are thus brought to the holding that no conversion has been proved. If, however, the contrary were assumed, the damages would be nominal (*Wood v. Fisk,* 215 N. Y. 233, 239)."

Ponder that. By reason of the transaction involving the $90,000 check A had received stock which the liquidator had later turned into $126,000 cash. The liquidator was trying to have his cake and eat it too. It was manifestly inequitable to treat B as a converter of the check without taking into account the value which A had received from B in the same transaction by giving the check.

Wherever there is a conversion, the damages are, without more, the fair market value of what is converted. But there may be more. Thus, if the plaintiff voluntarily receives back the property, that will mitigate the damages (Appendix A). So here; if the plaintiff received value by reason of a transaction of which the alleged conversion was a part, that transaction should be viewed as a whole, and the damages for the conversion should be reduced by reason of the value which passed from B to A.

There was no justification for citing *Wood v. Fisk.* In that opinion Judge Cardozo gave sanction to the idea that there may be a conversion for which the damages at first are only nominal,

[7] 236 N. Y. 478, 141 N. E. 922 (1923).

but the damages for which may swell by reason of later events into full damages. But in the principal case the damages were *full,* but they were *reduced* by an off-set. The setup of the two cases is quite different, yet Judge Cardozo thought of the two cases as similar.

Then he gave even another meaning to " technical conversion " in *McCoy v. American Express Co.*[8] in an opinion written after he had become Chief Judge of the Court of Appeals. Certain rugs and other chattels were owned by A. They were in a warehouse in Paris. They had been attached. A gave a power of attorney to X, empowering X to take possession of the chattels and sell or otherwise dispose of them for A's account. To discharge the attachment, X obtained a loan from B and orally promised B that he, X, would hold the chattels as security for the loan. *B did not take possession of the chattels or the warehouse receipt therefor.* X took the chattels from the warehouse, and, failing to make a sale, shipped them to New York by the American Express Co., X being named as consignee in the bill of lading. The express company, after the arrival of the chattels in New York, delivered them to A, and B sued the express company for a conversion of the chattels. There was no proof of French law, therefore the case was determined by the law of New York. The court held that, as there had been no delivery of the chattels or the warehouse receipt by X to B, B had not acquired any *legal* interest therein.

But B made a second contention. He contended that, in any event, he had an *equitable* interest therein. In opening the discussion of this second contention, Chief Judge Cardozo said that when once the court departed from the contention that there was a " technical conversion," certain doctrines of equity must be considered.

Here he used the expression " technical conversion " as though it were equivalent to a good old-fashioned, full-blooded conversion at common law (to wit, a conversion), common law being *contrasted* to equity. He seems to have been unconscious that he was here using the expression in a meaning diametrically opposite

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[8] 253 N. Y. 477, 171 N. E. 749 (1930).

to the meaning in which he had, fifteen years before, used it in *Wood v. Fisk.*

Criticism Number 6.

The opinion left the New York law in doubt as to whether or no a tortious repledge *is* a conversion. It has been in doubt ever since and is still in doubt (p. 359). Whatever else that opinion did or did not do, it certainly gave New York a quarter century of doubt upon the very important question whether a tortious repledge by a stockbroker of his customers' securities really amounted to anything, provided only that the stockbroker was lucky enough to be able to redeem from the repledgee.

We hope that, when next that question is presented to the New York Court of Appeals, that court will hold that it is a conversion. How any other decision can be reached in view of the pertinent legislation of New York (p. 335, note) and of the United States (p. 365) we do not see, but if the law of New York on this point shall eventually be once more established on a simple and sensible basis it will certainly not be due to *Wood v. Fisk.* It will be so established, not *because* of the opinion in that case, but *in spite of* that opinion.

Criticism Number 7.

The thought of Judge Cardozo that the tortious pledge was a tort for which only nominal damages were appropriate is out of joint with other New York cases on conversions by brokers.

Compare *Hoffman v. Carow* [9] with *Wood v. Fisk.* In the first of these two cases, A's chattels got into the possession of a rascal, B. He brought them to C, an auctioneer, who acting in good faith and with due care sold and delivered them to D, a bona fide purchaser, and paid the proceeds, less his commission, to B. C was held liable as a converter to A (p. 127).

Now, in *Wood v. Fisk,* B did an act which violated the express terms of the pledge by A to B, so that B knew he was doing something that he had no business to do, and B's act put A in a position where on default of B (not A) A's property rights might be utterly

[9] 22 Wend. 285 (1839).

destroyed, and A would not even have some property which he could chase into the hands of persons strangers to him. A blundering tortious transfer by a person who had both the white soul and the gray brain and the consequence of which was only an embarrassment to A, which did not work a destruction of A's property rights, is a *major* tort, with the implications of involuntary-purchase (*Hoffman v. Carow*); but a conscious tortious transfer which exposes A to the risk of a total destruction of his rights, even if he himself is guilty of no default or other misconduct, is only a *minor* tort for which, without more, only nominal damages are appropriate.

We do not see how, within the bounds of reason, a court can support the *Hoffman v. Carow* doctrine and nevertheless support the *Wood v. Fisk* doctrine.

Criticism Number 8.

The thought of Judge Cardozo that the tortious repledge was only a " technical " conversion is out of joint with the doctrine that any act which separates debt and security is, without more, a conversion of the security.

We supposed that it was clear law, recognized by all courts, that no pledgee may lawfully separate debt from security and that, if he does so, he is, without more, a converter. The Court of Appeals had recognized that such was the law. " Equity will not tolerate a separation of the pledge from the debt." [10]

Yet that is precisely what B has done. B passes the security to C. C gets, not A's debt, but a debt of B to C. B retains the debt against A, and regards himself (not C) as the owner of that debt. Why is that not a separation of debt from security and therefore clearly a conversion?

Criticism Number 9.

The thought of Judge Cardozo that the tortious repledge was only a " Tut, tut " matter is out of harmony with the thought of the New York legislature, expressed by the 1913 amendment to the Penal Code (our p. 335, note).

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10 *Bennett v. Austin*, 81 N. Y. 308, 322 (1880).

It is true that this act was passed after 1910 in which year occurred the facts on which *Wood v. Fisk* was based. But it was passed before the decision was written. Surely, the judiciary owes it to the legislature to give large consideration to the thought of the legislature and to incline to keep its own thoughts in harmony. The legislature had evidenced in an unequivocal manner that it was concerned over these tortious repledges. If loss did ensue it was a felony. Now, possibly it may be reasoned that that showed an intent by the legislature that, unless there was a loss, it should not be regarded as even a civil wrong. But that is not sensible. True, the legislature thought it was going too far to make the tortious repledge a felony if loss did not result, but we submit that the proper inference from the statute is that the legislature wishes to have the courts, so to speak, back it up by making the tortious pledge a civil wrong, even if no loss happened to occur. The legislature was out to stop these tortious repledges. Then how could a court with propriety characterize a tortious repledge as a wrong for which only nominal damages were appropriate?

Criticism Number 10.

The opinion tended to throw the law of New York into confusion with respect to the function of "demand and refusal" in conversion cases.

We showed in the foundation chapter on conversion that there are *six* species of conversion (p. 118). But in only the second species — tortious withholdings — is demand and refusal requisite or even relevant. True it is, that in *that* species of conversion it is of the essence; and true it is that there are probably more cases on that species of conversion than on all the other species combined (our guess is that about two-thirds of all reported cases on conversion in England and America are cases in which the plaintiff alleged that the defendant had tortiously withheld), and that therefore it may not be surprising that some weak judges, whose habit of mental life is to be unconcerned if the plow of the mind slips over the surface of the ground, have thought that

in *all* conversion cases demand and refusal were a condition precedent.

But an adequate examination of the authorities on conversion will bring out clearly that there are *six* species of conversion, and that the requirements and effects of different species are different. Thus a tortious withholding (the second species) forfeits the right *in rem,* but a tortious transfer (the third species) does not, under the *modern* law of pledge, forfeit the right *in rem.* Similarly, demand is necessary in species two; but is unnecessary in species three. Any person whose mind is so undiscriminating that he lumps all species of conversion together and thinks that the rules for all species are the same just has not got what it takes to be an efficient judge.

Most conversions by *pledgees* are either tortious withholdings or tortious transfers (p. 118). In that species of conversion which is a tortious transfer, the conversion is complete when the tortious transfer is made.

Yet ever since *Wood v. Fisk* the New York courts, or at least the courts inferior to the Court of Appeals, have seemed to be bewildered and some (not all) of the judges have thought that they were following Judge Cardozo's lead by holding that, although there had been a tortious repledge, yet there was no conversion until there had been a demand by the plaintiff upon the defendant to do something which, by reason of the tortious transfer, he no longer had the ability to do. See p. 359.

The weight of authority in this country is overwhelming that where there is a tortious transfer by a delivery made pursuant to an unauthorized sale, there is no need of a demand by the plaintiff upon the defendant before bringing his action. We submit that there is no justification for making a different rule where the tortious transfer is by way of an unauthorized repledge by B to C.

Criticism Number 11.

Closely connected with criticism number 10 is the effect of the opinion in leading some (not all) judges in the Appellate Division

to take the position that there may be a conversion through a failure to deliver something which the defendant has not the ability to deliver.

In the foundation chapter we traced the law from the time of the root case of *Isaack v. Clark* (p. 118), and showed that it had been established by numerous authorities that, while a withholding by a person who had the ability to deliver would be a conversion if such withholding were neither justifiable nor excusable, yet there was no conversion by a failure to deliver what the defendant had no ability to deliver, — that the essence of *that* species of conversion is a withholding, and that in the nature of things he who does not hold cannot withhold. A failure to deliver may be (and often is) a breach of contract but *it is not a conversion.*

The New York law on this point has been in confusion — great confusion — ever since *Wood v. Fisk.*

It may be noted that in *Mutual Trust Co. v. Merchants National Bank* [11] Judge Cardozo said: " Conversion, however we define it, involves at least the element of an *unauthorized assumption of dominion* (italics supplied), over the property of another. It logically follows that, where a defendant had at the time no dominion he could not make an " unauthorized assumption of dominion." But certainly some of the judges in the Appellate Division seem to have construed him otherwise.

Criticism Number 12.

The opinion tended to throw the New York law into confusion as to the rights of a plaintiff when the defendant's wrongful act was *both* a conversion and a breach of contract.

The law ought to be that in such case the plaintiff has an option to sue for a conversion and recover " involuntary-purchase " damages, and that he is not confined to " compensatory " damages, which are the damages appropriate to a breach of contract but which are *not* the damages appropriate to a conversion.

There has been a disquieting number of judges (some of them New York judges) who have said that when an act is both a breach of contract *and* a tort, the measure of damages should be

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[11] 236 N. Y. 478, 141 N. E. 922 (1923).

"just the same" whether the plaintiff elects to sue in tort or in contract. They have said that nothing should turn on the form of the action, and this certainly does sound progressive at first hearing.

But ponder that, and ponder it long.

Suppose that B has done an act entitling A to maintain trespass or trover at his election. This occurs whenever there is a conversion under the first of the six species of conversion specified at our p. 118, through a tortious *taking* of possession. Now, true it is that sometimes the damages will be the same, whether the action is trespass or trover. But frequently it will be different, — widely different. No one, so far as we know, has ever even to this day suggested that, where the measure of damages in trespass and trover is different, the trespass measure of damages is to be decisive. If the reader will pause to reflect, it will, we think, become clear that a court will be mocking a plaintiff if it says in one breath that he may, at his option, bring trespass or trover, and then, in the next breath, says that the damages will be "just the same" if he elects to bring trover as they would have been if he had elected to bring trespass.

Make an adequate appraisal of the fact that for centuries it has been clear law that, in certain cases, a plaintiff has an option to sue in trespass or in trover, and that *no* court has ever mocked such a plaintiff by telling him that, while he has an option to *label* his action trespass or trover as he pleases, the damages will always be trespass damages. The damages for a conversion are "involuntary-purchase" damages (p. 139 *et seq.*) and are (or may be) *different* from the damages for a trespass. Indeed, the chief reason why trover came to overshadow trespass *d.b.a.* in importance was because many plaintiffs preferred "involuntary-purchase" damages to trespass damages and *were allowed to have them, if* they elected to sue in trover.

Similarly, where defendant's act was both that kind of tort known as a conversion and a breach of contract, all courts say that in such case the plaintiff may, at his election, bring trover or assumpsit (or their substitutes under modern procedural statutes). What we are urging is that a court, having said that,

should not then proceed to take all practical significance out of it by holding that, if the plaintiff does elect to bring trover, the damages will be " just the same " as though he had elected to bring assumpsit. Such a doctrine shrinks the option to an option as to the *label* of the action.

No court ought to talk with its tongue in its cheek. If a court gives the option, the option should not be one merely as to label.

Differences in the measure of damages are not mere form, they are part of the substantive law. The difference between $2 and $1 is a difference of substance, not of form. The option given to A should be a real, not merely an illusory, option. If a court gives an option which, when analyzed, is only an option as to labels, it not only mocks the plaintiff but also stultifies itself.

We realize that a substantial number of judges (some of them judges of prestige whose utterances are entitled to respect) have said that the amount of damages should not turn upon the " form of action." We are not seeking to smother or evade that important fact. But we *are* challenging the propriety of that statement, and challenging it *totis viribus.*

" Substance, not form, should control." Of course. That is just as helpful as to say that right is right, and wrong is wrong. Banal. Do not gaze with admiration in the mirror when you find that you are so strong that you can force an open door.

What is " mere form "? *That* is the question. The difference between torts and contracts is *not* mere form. One might almost as well contend that the difference between torts, consciously committed, and crimes is mere form. To blur torts and contracts will undo centuries of hard, good, juristic work tending to make the law more definite and better adapted to meet the just requirements of varying states of fact.

The damages for a breach of contract are " compensatory " damages; the damages for a conversion are " involuntary-purchase " damages. In some cases there is a difference, often a *wide* difference in result. Therefore, if the defendant's act was both a conversion and a breach of contract, and the law declares that the plaintiff has an option to bring either trover or assumpsit (or modern substitutes), and the plaintiff elects to bring trover,

the court should not then mock him and stultify itself by saying that the damages will be "just the same" as though he had brought assumpsit.

And there is more to this. So far as we know, every judge who has said that in such case, with respect to the amount of damages, nothing should turn upon the form of action has *further* said that where an act is both a breach of contract and a conversion, the damages should be contract damages ("compensatory" damages), and not conversion damages ("involuntary-purchase" damages).

Time was, when it was said (1) that husband and wife were one person; *and* (2) that *he* was that person. Similarly there be those who say (1) assumpsit and trover (or modern substitutes) are one remedy; *and* (2) that *assumpsit* is that remedy.

Possibly, there were sufficient reasons for keeping (or attempting to keep) wives in subordination to their husbands. But we see no sufficient reason for keeping "involuntary-purchase" damages in subordination to "compensatory" damages. The claim that "compensatory" damages are more "fair and equitable," more in accord with "substantial justice" is unjustified.

We realize that there are those who sincerely believe that "compensatory" damages have some innate superiority to "involuntary-purchase" damages, — indeed, we incline to think that there is a rather widespread belief to that effect. We are convinced, nevertheless, that there is no superiority in "compensatory" damages over "involuntary-purchase" damages. We are not asking the reader to take our word for it. In preparation for this part of Chapter VIII we devoted many pages in Chapter V (p. 139 *et seq.*) to demonstrating that there is *less than nothing* in this idea, illustrating the practical working of the two rules by statement of actual cases. Please reread those pages.

And still more. Realize that the doctrine that the "form of action makes no difference," coupled with a corollary that damages in assumpsit-trover cases should be measured by assumpsit rules *abolishes the law of conversion in all bailment cases.*

That statement may surprise. We demonstrate. Wherever a bailee converts (usually by a tortious withholding or a tortious

transfer of the possession) he by that act also breaks a promise express or implied. Similarly, whenever a bailor converts (usually by a tortious taking) he by that act also breaks a promise express or implied. But, by reason of such statement *and such corollary,* there is no way to recover " involuntary-purchase " damages, and in that rule as to damages conversion moves and lives and has its being. Out of the window goes conversion in all contests between bailor and bailee.

Possibly, the whole law of conversion should be abolished. We think not. We have talked with many persons, most of them lawyers but some of them experienced business men, and (as it so happens) we have never found one person who was in favor of abolishing the law of conversion. On the contrary, we have found agreement that a law of conversion, within proper limits, is highly desirable, — that it affords a needed protection to persons who work hard and save, that it blocks rascals from profiting by their rascality, and that it tends to the use of *great* care in important business transactions.

Now, if the whole law of conversion is not to be abolished, we see no justification for abolishing it in all bailment cases.

Beware that seductive, Delilah-like statement and its attendant priestess of " compensatory " damages. They lure to destruction.

Now, in cases like *Wood v. Fisk* we not only concede but urge that the tortious pledge by B, the pledgee, to C was *both* a conversion and a breach of contract, and to that extent agree with Judge Cardozo. *But* — and the emphasis is on the " but " — we criticize him for sanctioning the idea that damages for a conversion may be anything but " involuntary-purchase " damages.

Criticism Number 13.

The opinion sanctions the thought that damages for a conversion may be nominal in the first instance, but may *swell* into full damages by reason of subsequent events.

There was, so far as we know, no authority whatever for such a doctrine prior to *Wood v. Fisk.* The law had always been that damages for a conversion were either (a) the fair market value

of what was converted (the property, *or* the plaintiff's interest if both plaintiff and defendant had interests therein), or (b) the replacement damages. For a full statement of this see the discussion of the *Salmon Weed* case at pp. 269–273.

This thought of Judge Cardozo receives no more support from reason than from authority. If the reader will pause and ponder we believe it will quickly become obvious to him that what Judge Cardozo did was to *talk* in terms of conversion but to *think* in terms of breach of contract. " Wait and see " is often necessary in measuring damages for a breach of contract. The swelling of nominal damages into large damages is a familiar phenomenon in breach of contract cases. The thoughts of Judge Cardozo were entirely appropriate if he were dealing with a breach of contract, but they were entirely inappropriate in dealing with conversion. Never forget that conversion damages are damages for a wrong done to a plaintiff's *property* rights, not his *contractual* rights. Reread Criticism Number 1.

Criticism Number 14.

The opinion adds to the confusion of the New York law as to whether the rule of damages as stated in *Baker v. Drake* (p. 265), which was accepted by the Supreme Court of the United States (p. 375) is, after all, the true rule.

Even so strong a court as the Circuit Court of Appeals of the Second Circuit was not strong enough to be immune from infection. See the discussion of the *Salmon Weed* case at pp. 269–273. Even *that* court *talks* conversion but gives a measure of damages which can be justified only by breach-of-contract reasoning. It did not advance to the altar in that temple which is dedicated to the worship of the Janus-faced God, with a left-side conversion face and a right-side breach-of-contract face. But it certainly did cross the threshold, and was " interested." It took a step — a disastrous step unless it stops — toward a process of reasoning which will undermine that fundamental of fundamentals, that a margin customer has *property* rights, rights *in rem* and not merely contract rights, rights *in personam*.

Test this matter another way. If B sells, all courts (except

Massachusetts) say that of course A may recover the proceeds of the sale in indebitatus assumpsit (or its modern procedural substitute). But does not this necessarily involve the proposition that what B sold was not B's property but was A's property?

If the helmsman will, in his steering, keep his eye on the beacon light of property rights, he will not run upon the rocks.

Conversion damages are involuntary-purchase damages, — the fair market value of what was converted at the time of conversion (or replacement cost under some circumstances). That is all there is to it.

But what New York law on this is, no man knows.

Criticism Number 15.

Judge Cardozo cited *Donald v. Suckling* as authority for a proposition which was not presented on the facts in that case, and as to which no one of the opinions contains even a dictum.

It is impossible for us to believe that Judge Cardozo had carefully perused that famous case. Compare *Donald v. Suckling* (our pp. 204–207) with *Wood v. Fisk*. In the English case, A had pledged to B, and B had then pledged for a debt of his own to C, but the security was *second-class* (our p. 22), and therefore C had only *derivative* rights. A brought detinue against C without tendering either to B or C the amount of A's debt to B. The court held that the pledge from B to C, tortious though it was, had not annihilated the pledge right *in rem*, and, therefore, that there must be a proper tender before A could maintain detinue. Mr. Justice Blackburn said: " The plaintiff should try the experiment whether, on bringing the money for which he pledged these debentures to (B) he cannot get them.[12]

There was no question at all in the case about nominal damages. Mr. Justice Shee thought the plaintiff was entitled to full damages. The other three judges held that judgment should be given for the defendant. Not one of the four judges said a word about nominal damages.

In *Wood v. Fisk*, the security was *first-class*, not second-class.

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[12] L. R. 1 Q. B. at bottom of p. 615. See our p. 206.

C had *independent* rights and was safe. *The action was not by A against C but was by A against B.*

Nevertheless, Judge Cardozo cites *Donald v. Suckling* as an authority on *nominal* damages in an action by *A against B.* "There are times, it is true, when a repledge, though illegal, will expose the broker to a liability for nominal damages and no more. This is so where the securities are redeemed and restored to the customer upon demand (*Donald v. Suckling*)."

We know of no other instance where a judge cited a case as an authority for a proposition which he wished to establish where there was more complete lack of justification for the citation.

Criticism Number 16.

The opinion reveals that Judge Cardozo misunderstood *Crawford v. Burke.*

He said that that court held that the claim of A was founded "upon a contract express or implied." [13] It did not. Subdivision 4 of Section 63 was in the alternative; the claim might be founded upon an open account, *or* upon a contract express or implied. The court relied on the first alternative, *not* the second. See our pp. 215–220.

Criticism Number 17.

The opinion reached a result by involved and circuitous reasoning, which should have been reached by simple and direct reasoning. It made a difficulty where there was no difficulty.

The case was covered by *Crawford v. Burke* (p. 215). Indeed, that case was an *a fortiori* case. The stockbroker in that case had sold the customer's securities and, on top of that, had tricked the customer into paying additional margins. The Supreme Court of the United States had unanimously decided that, nevertheless, a discharge in bankruptcy was a good defense to the action sounding in tort brought by the customer.

Due respect to decisions of the national court of last resort on a federal question called for axiomatic acquiescence in, and appli-

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[13] 215 N. Y. at bottom of p. 238 and top of p. 239. See our p. 227.

See also his remarks in *Davis v. Aetna Acceptance Co.*, 293 U. S. 328, 321, 79 L. Ed. 393, 55 Sup. Ct. 151 (1934).

cation of, that lucid opinion. That was all that was either necessary or appropriate.

A judge who had grasped the full significance of *Crawford v. Burke,* and who had an instinct for terseness and simplicity, could, we submit, have written an adequate opinion in *Wood v. Fisk* which, after reciting the facts and the pleadings, would not have exceeded twenty lines in length. There was no need for, and no propriety in, reaching the result (which should have been easily and quickly reached on the authority of *Crawford v. Burke*) by the involved and circuitous reasoning which Judge Cardozo did, in fact, employ.

In conclusion:

The opinion has all the appearance of lucidity, but all the reality of confusion. Exposed to analysis, it collapses.

That opinion was one of the most mischievous opinions that has been made in the twentieth century on a question of business law of daily recurring importance to a large number of citizens.

It seriously impaired the prestige of the New York Court of Appeals as a source of light and leading to the rest of the country on the law of Margin Customers. Since New York has so many more cases on this topic than any other state, New York was the natural leader. In the nineteenth century there were some strong New York decisions. New York did give a lead which other courts, including the Supreme Court of the United States, were strongly inclined to follow. But no shrewd court is going to follow the lead of a dust-cloud.

But what, says the disillusioned reader, are you going to do about it? You have been destructive. Be constructive. Take the burden of showing how the law could be made any better. What *ought* the law to be? That is a fair question, and we have pondered long over the answer. The fundamentals of our answer are as follows:

1. When A pledges to B, certain promises are implied by the law (where no such promises are made in fact). We will not pause to inventory all the implied promises, — some of which are

by the pledgor and some are by the pledgee. For our purposes, the important implied promises by the pledgee are (1) that he will make no tortious transfer of the possession, and (2) that he will, on proper tender and demand by the pledgor, hand over to the pledgor the pledge (or its equivalent).

2. When B makes a tortious pledge to C, that act is both a breach of implied promise No. 1 and a conversion. The damages for breach of the contract are, as yet, only nominal, but the damages may by reason of subsequent events swell from nominal damages to full-value damages. One must "wait and see" whether this swelling will occur. But the measure of the damages for the conversion are fixed at once. Conversion damages are the fair market value of the pledge (or, in some circumstances, replacement cost) less the debt.

3. Therefore *at once* A has a cause of action in tort against B, in which he is entitled to recover against B at least the fair market value of the pledge at the date of the conversion, less the debt.

4. As yet there has been no breach of implied promise No. 2. There will be no breach (except by the fiction of anticipatory breach) until tender, demand and refusal.

5. If later, there is a breach of implied promise No. 2, A should be given a real, and not merely an illusory, option to sue for the conversion *or* for breach of implied promise No. 2.

6. The breach of implied promise No. 2 gives rise to a cause of action at a date *subsequent* to the tortious pledge. Here the analogy of *Wilkinson v. Verity* (p. 203) and part of the reasoning in the *Dimock* opinion (p. 200) are helpful. A lapse of time which would give a defendant a defense under the Statute of Limitations for the conversion will not give a defense to an action based on the breach of the promise to return. Similarly, a discharge in bankruptcy which would be a defense in an action based on the conversion or breach of implied promise No. 1 may not be a defense against an action based on breach of implied promise No. 2.

7. Call the damages for the conversion X.

The damages for the breach of implied promise No. 2 will be the fair market value of the pledge at the date of the tender, demand, and refusal (less the debt). Call such amount Y.

If the market value of the stock falls after the conversion, A will naturally sue for X. If it is higher at the date of the tender, demand and refusal, A will naturally sue for Y.

Under such law, a tortiously-pledging B will know that all chance of gain is with A, and that all chance of loss is upon him, B.

That will touch the pocket-nerve of B, and will have a strong tendency towards deterring him from such tortious pledge.

8. We are convinced that there is great need for such a deterrent, and find it difficult to understand how anyone familiar with the facts of business life should fail to see that there is such great need.

To restate the pith of these eight points. A should be allowed to sue B for the conversion of his pledgor's interest by a tortious transfer, *or* to sue B for breach of the promise to return upon proper tender, demand and refusal.

We submit that the above plan affords a proper civil deterrent to tortious pledges, — neither too much nor too little. Whether there should *also* be a criminal deterrent is for the decision of the legislature having jurisdiction.

Two objections will be made to this plan. First, that it is contrary to the authorities holding that in conversion the damages are always for the full value of the property in question. Second, that it is contrary to the authorities holding that neither trover nor any statutory substitute therefor may be maintained by any plaintiff unless he had the right to immediate possession of the property converted at the time of the conversion.

As to the first objection. It is true that in an action for conversion the damages are always for the full value of the property in question, *except* when both plaintiff and defendant have interests therein. But, if B, one tenant in common, deprives A, his co-tenant, of his due rights, A may hold B as a converter, and A recovers, *not* the full value of the property, but only the value of A's interest therein. Similarly, if A bails to B, and A converts

(as by an unauthorized taking back), B may hold A as a converter, but B recovers, not the full value of the property, but only the value of B's interest. This has long been clear law (p. 210, note 34).

We therefore can see no reason why, in bailor-bailee cases, (and pledgor-pledgee cases are one species of bailor-bailee cases) the bailor should not have a right *reciprocal* to the bailee's right. If A bails to B, and B converts (as by a tortious withholding or transfer), A should be allowed to hold B as a converter, but should recover, not the full value of the property, but only the value of A's interest. That A has such right in case B's wrongful act is a delivery pursuant to an unauthorized sale is plain on the authorities. We can see no reason why he should not have such right if B's wrongful act is a tortious pledge.

The second objection (right to immediate possession) calls for a much longer answer. We divide the answer into four parts:

1. A bails to B, and C converts. Assume that there is no statutory substitute for the action of trover.

This is the *Gordon v. Harper* (p. 152) problem. We have given in detail at pp. 152–159 our reasons for believing that American courts should follow the lead of Mr. Justice Story, rather than the lead of this case, which was not well reasoned and the soundness of which has been doubted even in England.

2. A bails to B, and C converts. Assume that by statute trover has been abolished and some other remedy has been substituted.

In the *Raymond-Syndicate* case (p. 161), a narrow construction of the supposedly remedial procedural statutes was made by reason of which construction hopes for a substantial improvement were dashed. But the remedial statutes in most, if not all, the other states, are different and we hope and believe that other courts will not follow the lead of that case. Possibly, the Massachusetts court may hereafter frankly say that the construction adopted in the *Raymond-Syndicate* case was unduly narrow. Even if it does not, we believe that that case will have only local sway.

The technical difficulty out of the way, the court will then be free to consider the question of substantive law, — to wit, if a

part owner in possession may recover whole damages, is there any reason (outside of Plantagenet traditions) why a part owner out of possession should not recover whole damages? We are confident that at least most courts, once they realize that by statute they have been emancipated from technical procedural difficulties, will answer this question of substantive law as Mr. Justice Story answered it.

3. A pledges to B, and B (not a C) converts. Assume that there is no statutory substitute for the action of trover.

Here, there is no question of substantive law. A does not seek whole damages. He is a part owner who is seeking part damages, — damages limited to and measured by the value of his interest. We submit that here, at least, an exception should be made to the general rule which requires that a person seeking to qualify as a plaintiff in trover must allege and prove that he had either the possession or the right to immediate possession at the time of the act complained of. The common law has again and again developed by making sensible exceptions to general rules. Even in the action of trespass *d.b.a.*, an action going back to the very dawn of the common law, at least four exceptions — and important exceptions — have been made to the general rule that a person seeking to qualify as a plaintiff must allege and prove that he had possession at the time of the act complained of (pp. 157–158). Then why must there be absolute rigidity with regard to the requirements for qualifying as a plaintiff in an action of trover, which is one species of an action on the case, and was adopted pursuant to a plan that for every wrong there should be *a remedy to fit the case?*

When the question of substantive law — of allowing a part owner to recover full damages — is presented, there is room for a difference of opinion among intelligent men as to what is the proper answer. But when that substantive question is *not* presented, it seems to us to be clear that the pledgor should be allowed to recover the value of *the pledgor's interest* from a converting pledgee, even if no remedy is available but trover.

4. A pledges to B, and B (not a C) converts. Assume that by statute trover has been abolished and some other remedy has been substituted.

In such case, *even Massachusetts* holds that A may recover from B as a converter, the damages being the value of *the pledgor's interest* (*Whitman v. Boston Terminal Refrigerating Case*, p. 163).

That case is journey's end. If Massachusetts, the *Raymond-Syndicate* case notwithstanding, sees its way to reach the sensible result, we are confident that most, if not all, other courts will do likewise.

So much for what may perhaps be fairly characterized as technical objections to the plan proposed. But is that plan on its merits adequate and wise? There is room for a difference of opinion on that. We are not asking any reader to take our word for it. We are only asking the reader to ponder the plan. It may well be that some other plan which is definitely better may occur to some one else. The only thing as to which we are clear is that the law ought not to continue in its present condition.

Wood v. Fisk delendum est. That *must* be done. Then it is desirable that legal architects compete with plans for the new structure.

Chapter V, on Trover and Conversion, must at a first reading have seemed to be rather heterogeneous. There were two special topics (pp. 139, 147). Each of those special topics was part of the preparation for *Wood v. Fisk*. If we had delayed consideration of those special topics until this chapter we should twice have had to make long digressions from the main stream of thought. Therefore, we thought that the lesser evil was to have a preliminary chapter (1) in which the reader might get familiar with the rudiments of conversion, and (2) in which there might also be the rather long discussions necessary adequately to present those two special topics, although the pertinence of those special topics in a book on Margin Customers would not at first appear. We hope that the reader will, at this point, turn back and reread pp. 139–147 and pp. 147–165. The significance and pertinence of those parts of that chapter will then appear.

An interesting question remains. Could adequate counsel have won for A in 1910 in a *Wood v. Fisk* situation? We are inclined

to think that he could. A should have given notice to B that A would at a defined time and place tender to the receiver in the bankruptcy proceeding the amount of A's debt and should have demanded that B should be at such time and place with the pledge (or its equivalent) so that, as parts of one transaction, A might pay the receiver and receive from B the pledge (or its equivalent). If B did not comply, he would break implied promise No. 2. Then A should have sued B, not in tort but in contract. He should have stressed the analogy to *Wilkinson v. Verity* (p. 203), and the reasoning in the *Dimock* case, and he should have won, *if* the claim on implied promise No. 2 (unbroken at the time of the bankruptcy) was not a provable claim.

Was it provable? It was not an absolute, but only a conditional, promise. There was a substantial chance that the condition would never be fulfilled. We incline to think that in 1910 the chances were that such a claim was not provable. See the terms of Section 63 of the Bankruptcy Act of 1898 given in the note on p. 335, and *Perry v Sturdevant*.[14]

Today, we should think the chances that A might win on this ground were probably gone. Congress has kept enlarging the scope of "provable debts" (why, in the name of clarity and simplicity does it not just say that *every* claim in contract, at least if such claim is susceptible of liquidation, is provable?); and the Supreme Court has given wide application to the thought that the bankruptcy itself causes an anticipatory breach of contract obligations. In the last thirty years there has been a marked advance toward the "fresh-start" objective.

Today, on like facts, *Wood v. Fisk* is no longer law. But that is because of the penal legislation of 1913.[15]

We close this chapter with an examination question (Property I, June 5, 1940). A reader who is a student might find it prof-

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[14] 128 Misc. (N. Y.) 338, 218 N. Y. S. 678 (1926).

[15] See *Heaphy v. Kerr* (p. 335, and note 1 on p. 335), but *cf. Brown v. Hoyt,* 145 Misc. 915, 261 N. Y. S. 355 (1932).

itable to test his grasp of the subject by writing out an answer to that question.

On February 1, 1900, in New York, A bought on margin through B, a stockbroker, 200 shares of the stock of the X corporation for $20,000, paid B $2,000, and orally promised to pay B on demand the balance of the purchase price, with 5% interest. On February 5, B borrowed $200,000 from C, a bank, and tortiously pledged A's shares as part of the collateral. B promised C to repay the loan on demand and agreed that upon default C might forthwith sell all the collateral on the New York Stock Exchange. C was a bona fide pledgee.

On April 10, B was adjudicated a bankrupt, and R was appointed receiver of the estate. C duly called B's loan, and on default duly sold all the collateral on the New York Stock Exchange. The net proceeds exceeded B's debt by $20,000, and C paid R $20,000 on April 15.

On May 1, R demanded from A $18,225 ($18,000 plus interest at 5%). A procured a certified check for that amount payable to his own order, indorsed it in blank, and on May 1 made a conditional tender of it to R, the condition being that R or B should deliver to him 200 shares of X. At the same time he demanded that R should take the check, *and* should, as part of the transaction, deliver to him 200 shares of X. At the same time he demanded of B that B should deliver to him 200 shares of X upon his paying $18,225 to R. Both B and R absolutely refused to deliver to A 200 shares of X. Neither B nor R, as receiver, had in his possession or control 200 shares of X. Thereupon A deposited the check in his own bank account.

A had no notice of B's tortious pledge to C until April 1. He filed no claim in the bankruptcy proceedings. A brought an action against B, seeking to recover the value of 200 shares of X (to be valued as of such date as the court should determine) less $18,225. While this action was pending, B received his discharge in bankruptcy and thereupon duly pleaded his discharge.

T, who had become the trustee in bankruptcy and had therefore succeeded to all the rights of R, as receiver, brought an ac-

tion, as trustee, against A, seeking to recover $18,225, with interest at 6% (the legal rate) from May 1, 1900. By agreement of the parties the two actions were tried together.

Shares of X sold on the New York Stock Exchange on February fifth at 102, rose to 130 on March twenty-fifth, fell to 120 on April first, rose to 122 on April fifteenth and fell to 115 on May first.

Assume that on April 10, 1900, a provable debt in bankruptcy proceedings could not be based on the breach of a contract made before the promisor became bankrupt if (1) the promise was not broken until after the promisor became bankrupt; and (2) the promise was not a promise expressed in writing to pay a sum of money; and (3) it was not certain that the promisor would ever have a duty, under the terms of the contract, to do anything.

What judgments should be entered in the two actions?

State first the two judgments, then give your reasons. Dismiss with a single sentence every point on which you think the law is clear. Maximum, four pages.

Chapter IX

TORTIOUS TRANSFERS OF FIRST-CLASS SECURITIES
(*Continued*)

The New York Law in Detail

BELOW are given in chronological order all the cases we have found decided in New York in or since 1863 (the date when the modern law of pledge began, p. 196) which we think may be helpful to practicing lawyers. We comment on many, but not all, of these decisions.

Romaine v. Van Allen, 26 N. Y. 309 (1863)

A pledged stock with B, a broker, to secure a demand note. B sold the stock without having made a demand for payment. A sued for a conversion. The stock was worth $3,937.50 when sold. The highest market price between the sale and the commencement of A's action was $5,962.50. The trial of the action was protracted and during the trial the price rose at one time to $8,175. A recovered $8,175, less his debt.

Comment:

A pledgor was allowed to recover for the conversion by the pledgee of the pledgor's interest. The court took it in its stride that there was no objection to this. " The only question in the case is as to the measure of damages " (p. 310).

Milliken v. Dehon, 27 N. Y. 364 (1863)

The terms of a pledge of cotton were construed and the pledgee was held justified in making a liquidating sale " by sample, not at public sale, but in the ordinary way that the article is sold in the New York market " (p. 366).

Scott v. Rogers, 31 N. Y. 676 (1864)

A had shipped wheat to B, a commission merchant in Buffalo. On July 12, 1853, A telegraphed B to sell on that day at a certain price, or if not sold on that day to ship to X in New York City. B sold the wheat at eight o'clock in the morning of July 13. " This

was a clear breach of duty, and in effect, a conversion of the property; and the question returns, what damages was the plaintiff entitled to recover" (p. 680). There should be no difference in the rule of damages "whether the action be for breach of contract or for violation of duty" (p. 679). The trial judge had charged that the measure of damages was the difference between the price at the time of the conversion and a reasonable time afterwards within which to commence the action. He had ruled that such reasonable period was four months after the time when the wheat, if duly forwarded, would have reached New York City. The court held that there was no error in such charge or ruling.

Comment:

Here is a statement that there is no difference in the damages "whether the action be for a breach of contract or for a violation of duty." This is not the same as saying that the damages for breach of contract are the same as damages for a conversion, but it is edging in that direction.

Genet v. Howland, 45 Barbour 560 (1866)

A had given a demand note to B, secured by pledge. The court discussed the conditions on which B was authorized to make a liquidating sale.

Lewis v. Mott, 36 N. Y. 395 (1867)

A pledged "Illinois canal certificates" to B to secure his time notes. A defaulted. B sold the scrip to C by an instrument which recited that the scrip was transferred by A to C as a pledge. Later, C sold the scrip at auction and bought it himself. No demand of payment had been made on A, and no notice of the sale had been given him. Later, A offered to pay the notes and demanded the scrip. Some of the scrip had prior to the demand been paid by the State of Illinois. A sought an accounting and other relief.

The trial court gave judgment for A against C as for a conversion of the scrip. The General Term reversed this, and ordered final judgment for C, and the Court of Appeals affirmed the judgment of the General Term.

Scrugham, J., held that A could not recover since in his complaint he had treated the assignment from B to C as lawful, and had asked relief based on the thought that C had been substituted for B as pledgee, but the trial court had given relief on the basis that this was a tortious transfer.

Davies, Ch.J., said that B was fully authorized to sell the canal scrip upon nonpayment of the notes, and that C was not a substituted pledgee. Since there was no basis for an accounting, the complaint should have been dismissed. The Chief Judge further said that the offer was " insufficient to extinguish the lien (our p. 12) and thus entitle [A] to the possession of the notes. He could not, clearly, maintain an action for conversion unless he was entitled to such possession. Until a wrongful detention after a demand and refusal were shown, there was no evidence of a conversion. . . . A tender of the amount due on the two notes, assuming [C] held them as the substitute of [B] might have entitled [A] to the possession of the securities. But, clearly, on no theory was he entitled to have them, except upon payment of the amount of the lien, or a tender and refusal. Such tender has not been made. The offer to pay is not the equivalent for an actual tender" (p. 401).

Comment:

We think that this case has been often misunderstood. A had defaulted, and B had made a transfer to C. Assume that that transfer did not have the effect of a liquidating sale and so vest the absolute title in C, and that it only passed to C what rights B had. Then the question was: May a pledgor hold the pledgee's assignee liable as a converter for a refusal to surrender the pledge, if the pledgor does not tender the debt? Of course not. The opinion of Davies, Ch.J., is in harmony with the decision (made about a year before) in *Donald v. Suckling*, our p. 204.

This case has been sometimes misunderstood as holding that there must always be demand and refusal in conversion cases. Not at all. Here it was alleged that the defendant tortiously *withheld*. A tortious withholding is the *only* species of conversion (p. 118) where demand and refusal are requisite.

Hanks v. Drake, 49 Barbour 186 (1867)

A was a margin customer. B called for more margin, and two hours later made a liquidating sale. It was held that by reason of subsequent facts A had ratified the sale.

Ingraham, J., also discussed the proper disposition of the case if there had been no ratification. He thought that B should have given A reasonable time to comply with the margin call, and that on all the facts (including a previous dealing between the parties) two hours was not a reasonable time.

Markham v. Jaudon, 41 N. Y. 235 (1869)

The margin of a customer had been exhausted, and the stockbroker, doing business in New York City, had sold the stock bought for account of the customer without giving him notice of the time and place of the sale. The customer sued for a conversion.

The defendants offered to prove a *custom* of the board of brokers authorizing brokers to sell out the stocks of their customers on the exhaustion of the margin. This was rejected, and the defendants excepted. It was proved that the plaintiff was familiar with the custom of brokers in the city of New York.

The trial judge ruled that in determining damages the stock was to be valued at "the highest market value of the stock between the date of the conversion and the trial" (p. 237), to which ruling the defendants excepted. The report does not expressly state, but it is demonstrable from the figures, that the damages were the highest market price of the pledge less the customer's debt to the stockbrokers.

The court divided, six to two, the majority overruling all exceptions. This is one of the half dozen most important of the New York cases.

The opinion for the majority was given by Chief Judge Hunt. He said that the stockbrokers were not owners, but merely pledgees; that they were required at all times to have in their name or under their control, ready for delivery, the stocks purchased, or an equal amount of other shares of the same stock, and to deliver such shares to the customer when required upon payment of his

debt; that the stockbrokers became pledgees of the stock for the money advanced in their purchase; that the pledgees were subject to the rules of the common law applicable to liquidating sales; that the fluctuating value of the pledge was immaterial; that "to authorize the defendants to sell the stock purchased, they were bound first to call upon the plaintiff to make good his margin; and, failing in that, he was entitled, secondly, to notice of the time and place where the stock would be sold; which time and place, thirdly, must be reasonable" (p. 243); that the broker had no right to sell without proper notice and that "a practice or custom to do otherwise would have no more force than a custom to protest notes on the first day of grace" (p. 245); that such practice "would be in hostility to the terms of the contract, an attempt to change its obligations, and would be void" (p. 245).

As to the measure of damages, he only said that "this is an action for the conversion of the stock, and the rule of damages was correctly laid down," citing three cases (p. 245).

Grover, J., and Woodruff, J., the dissenting judges, both thought that the relation between A and B was *not* that of pledgor and pledgee; that B, the stockbrokers, were the *owners* of the stock purchased, that the customer and the stockbroker owed each other certain duties arising by reason of the *contract* between them; that when the customer failed to perform his side of the contract, the stockbrokers were at liberty to sell without more; and that, in any event, the damages should only be such as A actually suffered.

Per Grover, J., "The defendants could not make themselves liable for a tortious *conversion* of the stocks of the plaintiff, for the reason that *the plaintiff had no title* to such stock. The contract contemplated that the *title should at all times remain in the defendants.* In case they failed to perform the contract, the plaintiff having performed on his part, he could maintain an action, *not for the conversion of the stocks, but for his damages sustained by the breach of the defendants* . . . (p. 250). I shall *not* discuss the cases holding that the rule of damages for the wrongful conversion of property is the highest price between the conversion and the trial" (p. 251; italics supplied).

Per Woodruff, J., "The *title* to the stock was not in [the customer] but only such chance of profit. He had not paid for the stock. He has sustained nominal damages only, for *he can buy the stock in the market, if he wishes to continue the adventure*" (p. 257; italics supplied).

Comment:

1. The court divided, six to two, upon *the* fundamental question, — the fundamental of fundamentals in the law of margin customers: Who is the *owner* of the stocks which a stockbroker purchases for account of the margin customer? The six said that the customer was the owner, and the stockbrokers only pledgees. The two said that the stockbrokers were more than pledgees, that they were the owners.

We believe that the conception of the dissenting judges on this is out of joint with the conception of business men, and that it is also out of joint with the usual legal conception that he is owner who has the chance of gain and the risk of loss; and that the majority of six were right on the fundamental question as to what is the relation between margin customer and stockbroker. The view of the majority is law both in New York and throughout the United States, Massachusetts alone excepted.

2. The six thought that stockbroker pledgees were subject to the rules of the common law applicable to all pledgees; that they were not a specially favored class of pledgees; and that they could not occupy a more favored position by reason of a *custom*. The decision is squarely against allowing a custom of the street to override the rules of the common law.

3. The six squarely hold that there may be a conversion *of a pledgor's interest*. They took that in their stride.

4. There was no careful consideration of the measure of damages for such a conversion. Only four lines were given to that point. The fight between the six and the two was on the fundamental, underlying question whether there had been a conversion or only a breach of contract, whether the margin customer has property rights, rights *in rem*, or only contract rights, rights *in personam*. Never forget that that is *the* fundamental question, — the fundamental of fundamentals.

Strong v. National Mechanics Banking Association, 45 N. Y. 718 (1871)

A borrowed from B on pledge. B made a tortious sale. A recovered the value of the pledge, less the debt.

Comment:

Another case of the conversion of a pledgor's interest.

McNeil v. Tenth National Bank, 46 N. Y. 325, 7 Am. Rep. 341 (1871)

B (stockbrokers) was carrying stock for A. A delivered to B as security for that account a certificate for shares in X, which A owned outright. A had indorsed this certificate in blank. B pledged it to C, a bona fide pledgee, for an amount larger than A's debt to B. The court held that A was entitled to obtain it from C *only* upon paying so much of the B, C debt as remained unpaid.

Comment:

This is an outstanding authority on the possession, *plus,* doctrine. See our pp. 25, 26. C got what it thought it was getting; its rights were *independent,* not derivative. Note that at this time certificates of stock indorsed in blank had not by statute in New York been made negotiable instruments. They were not made negotiable until 1926.

Stewart v. Drake, 46 N. Y. 449 (1871)

A's margin was impaired. On Thursday afternoon B gave notice to A that his stocks would be sold at public auction on the following Saturday at 12:30 at a place specified; and a sale was made accordingly. This " was a timely and reasonable notice, the parties being and living in the city of New York where the sale was made " (p. 455).

Douglass v. Dudley, 48 N. Y. 688 (1872)

B tortiously pledged a note belonging to customer No. 1 and stock belonging to customer No. 2 to C, a bona fide pledgee. Customer No. 2 redeemed the pledge from C by paying the B, C debt. Held, that customer No. 2 was entitled to sue on the note of cus-

tomer No. 1, and to recover contribution in the proportion that the amount of the note bore to the value of the stock.

Porter v. Parks, 49 N. Y. 564 (1872)

B sold at the direction of X who was not an agent of A. A sued for a conversion. Direction of a nonsuit was error.

Taft v. Chapman, 50 N. Y. 445 (1872)

Bonds payable to bearer belonging to X were stolen by A and pledged to B, as security for stocks purchased for the account of A. The sale by B of bonds *beyond the amount of A's debt* was a conversion for which B was liable to X.

Bryan v. Baldwin, 52 N. Y. 232 (1873)

B delivered the pledge to an auctioneer for sale. He bid it in himself. That gave A an option to avoid the sale and treat it as a *nullity.* He elected so to do. Then he cannot hold B liable as a converter, even if the sale were made without proper notice.

Lawrence v. Maxwell, 53 N. Y. 19 (1873)

The defendant was a gold and stock broker in the city of New York. The stock in question was deposited as security against any loss which the broker might sustain by reason of purchases and sales of gold to be made on account of the plaintiff. The transactions resulted in a loss. Plaintiff tendered the amount of the debt and demanded the stock. Defendant replied that he could not give it as he did not have it. What he had done with it is not stated in the report, but from the language used in the opinion apparently he had pledged it to a C.

At the trial the defendant offered to show a *custom* and usage by which a broker was authorized to hypothecate or otherwise use securities received by him as margins on transactions like those in question, and that the plaintiff had knowledge of such custom. The offer was rejected, and defendant excepted.

The court directed a verdict for plaintiff for the value of the shares, deducting the amount due defendant.

The exception that counsel for the defendant urged in argument was based on the rejection of evidence of the custom and the plain-

tiff's knowledge thereof. This was the fight. On this the court said that a custom could not ". . . derogate from the rights of the parties, or import into the contract new terms and conditions, or vary the legal effect of the transaction" (p. 21).

The court made two remarks about conversion. It said: "The action is not for a conversion by a use or pledge of the stock, but for a refusal to redeliver the stock after the payment of the debt for which it was given in security" (p. 22). But it also said that, conceding the right to hypothecate, it was defendant's duty to regain the possession and restore the same to the plaintiff. "A neglect or refusal to do so gave to the plaintiff an action as for a conversion of the property" (p. 23).

The measure of damages was not made a point upon the trial except *pro forma*. There was no exception to the charge of the judge.

Comment:

1. The fight was as to the relevancy of the custom and the plaintiff's knowledge thereof. The lead of *Markham v. Jaudon* was followed. *A custom to repledge was no more pertinent than a custom to make a liquidating sale without giving the notice required by the common law.*

2. We do not know whether the plaintiff asked to have the stock valued as of the date of the pledge, or as of the date of the failure to deliver. Probably the latter.

3. The plaintiff would seem to have been suing for breach of contract. In *Markham v. Jaudon* the court had said that it was the duty of the pledgee to have the stock ready to deliver if proper tender were made. If that were so, there should have been no talk about conversion. The second remark of the court was unfortunate. It gave some basis for claiming that a failure to deliver what the defendant had no ability to deliver might be treated as a conversion. This is inconsistent with the line of authorities which we have set forth at pp. 120–123.

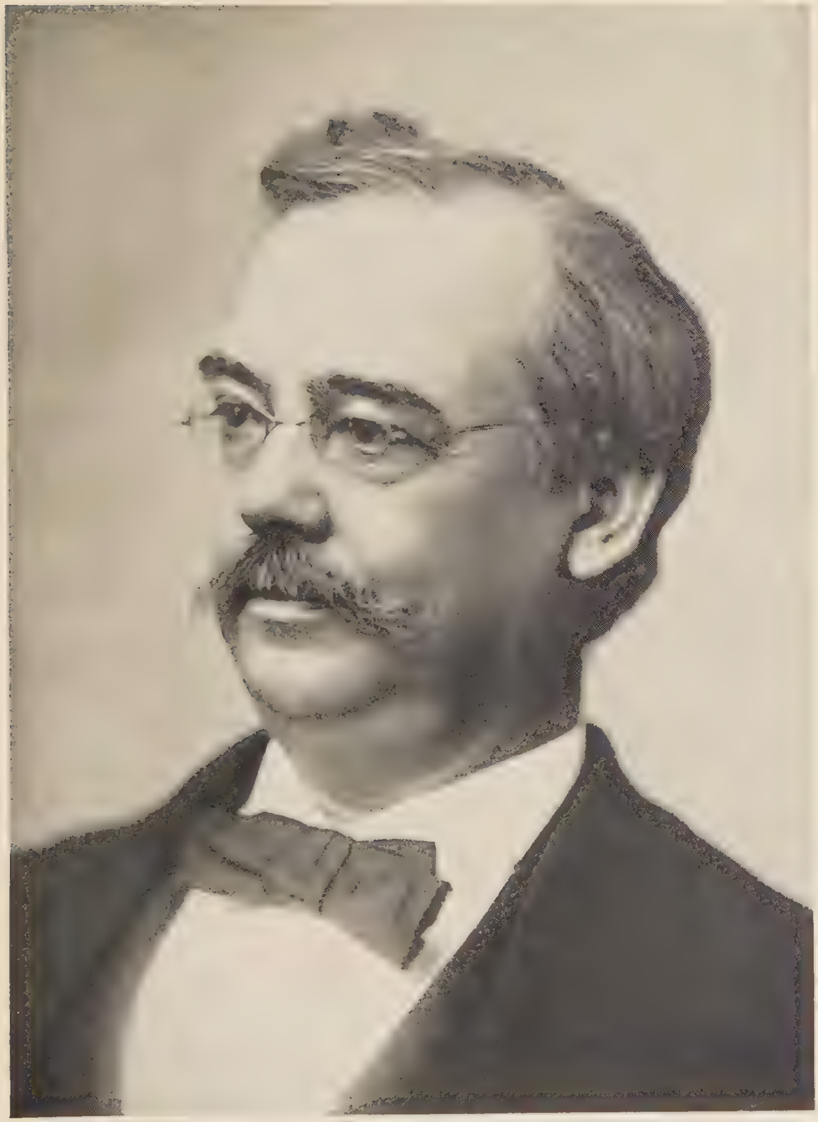
Baker v. Drake, 53 N. Y. 211, 13 Am. Rep. 507 (1873)

The only question discussed was the measure of damages for an unauthorized liquidating sale by a stockbroker of stocks bought

for the account of a margin customer. The stock had been sold at $134 a share. Afterwards it had risen somewhat before action was brought, and after action brought it at one time rose to $170. The plaintiff had been given damages computed by deducting the proceeds of the sale at 134 from the amount of proceeds which a sale at 170 would have yielded.

The opinion was by Rapallo, J., who said: "Whether the present action is one for the *conversion* of property of the plaintiff, or *for the breach of a special contract,* presents a *serious question,* but that inquiry is *perhaps* unimportant on the question of damages and will be deferred for the present, and the case treated *as if it were one of conversion.* Regarding it in that light, the question is whether or not, under the circumstances of the case, the rule adopted by the court below affords the plaintiff *more than a just indemnity for the loss he sustained by the sale of the stock.* This enormous amount of profit given under the name of damages, could not have been arrived at except upon the unreasonable supposition, unsupported by any evidence, that the plaintiff would not only have . . . carried [the stock] through all the fluctuations until it reached its highest point, but that he would have been so fortunate as to seize upon that precise moment to sell, thus avoiding the subsequent decline, and realizing the highest profit which could have possibly been derived from the transaction by one endowed with the supernatural power of prescience. In a case where the *loss of probable profits* is claimed as an element of damage . . . its amount is a question of fact, and a finding in respect to it should be based upon some evidence . . . An amount sufficient to indemnify the party injured for the loss, which is the natural, reasonable, and proximate result of the wrongful act complained of, and which a proper degree of prudence on the part of the complainant would not have averted, is the measure of damages which juries are usually instructed to award, except in cases where punitive damages are allowable" (pp. 213, 215; italics supplied).

He then said that if there had been a tortious sale A might require B to replace the stock, or if B refused or failed to do it, A should buy himself and charge B with the loss reasonably sustained in doing so. "The advance in the market price of the



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Judge of the New York Court of Appeals

stock from the time of the sale up to a reasonable time to replace it, after the plaintiff received notice of the sale, would afford a complete indemnity . . . the customer is entitled to recover such damages as would naturally be sustained in restoring himself to the position of which he has been deprived. He certainly has no right to be placed in a better position than he would be in if the wrong had not been done. But the rule adopted in *Markham v. Jaudon,* passing far beyond the scope of a reasonable indemnity to the customer whose stocks have been improperly sold, places him in a position incomparably superior to that of which he was deprived. It leaves him, with his venture out, for an indefinite period, limited only by what may be deemed a reasonable time to bring a suit and conduct it to its end. The more crowded the calendar and the more new trials granted in the action, the better for him. He is freed from the trouble of keeping his margins good and relieved of all apprehension of being sold out for want of margin. If the stock should fall or become worthless he can incur no loss, but, if at any period during the months or years occupied in the litigation, the market price of the stock happens to shoot up, though it be but for a moment, he can, at the trial, take a retrospect and seize upon that happy instant as the opportunity for profit of which he was deprived by his transgressing broker, and compel him to replace with solid funds this imaginary loss."

At one point he said: "It may be as well to remark here as anywhere that *the rule of damages should not depend upon the form of the action.* In civil actions the law awards to the party injured a just indemnity for the wrong which has been done him, and no more, *whether the action be in contract or tort;* except in those special cases where punitory damages are allowed, the inquiry must always be, what is an adequate indemnity to the party injured, and *the answer to that inquiry cannot be affected by the form of action in which he seeks his remedy*" (p. 220; italics supplied).

After reviewing the authorities he concluded that the *Markham v. Jaudon* rule was not a fit rule applicable in the case at bar "whether the cause of action be deemed for a conversion of prop-

erty or the breach of contract" (p. 224), and that the dissenting opinions of Grover and Woodruff, JJ., "embody the sounder reasons, and that the rule of damages laid down in that case and followed in the present one is not well founded, and should not be sustained" (p. 225).

Comment:

1. This opinion is famous, and deserves its fame. Probably no other opinion on the subject of margin customers has had more influence, and few, if any, have had as much. The Supreme Court of the United States followed Judge Rapallo's lead, as we shall later see (our p. 375).

2. Was B the owner or merely a pledgee? That was *the* question in *Markham v. Jaudon.* We believe that when he wrote this opinion Judge Rapallo had not yet reached a clear conclusion on this matter. When this *Baker v. Drake* litigation again came before the Court of Appeals (p. 276) the court divided on this fundamental question, five holding B to be pledgee, and two holding him to be owner, and Judge Rapallo was one of the two. But a study of the opinion on the first appeal written by Judge Rapallo shows him as thinking of this as a "serious question" which he did not find it necessary to answer. He ultimately based his decision on the thought that, *anyway,* whether A's action was for breach of contract or tort, the old rule (the rule not originated, but sanctioned without discussion, by *Markham v. Jaudon*) was indefensible.

He smashed that old rule to pieces. And nobody has ever put the pieces together, and we venture to predict that nobody ever will. Judge Rapallo did a one hundred per cent destructive job.

Is the new rule justifiable? We understand the new rule to be that the property pledged is to be valued at the highest market price at any time between B's wrongful act and the expiration of a reasonable time (to be determined by the court) after notice of the act. We shall see later in discussing the *Salmon Weed* case (pp. 269–273) that there is authority in favor of valuing at (1) the market price at the date of the wrongful act, or (2) the highest market price between the date when A received notice of the

wrongful act and the expiration of a reasonable time thereafter, whichever is the higher. We might as well consider at once which of these two proposed new rules is the better.

Judge Rapallo was of opinion that it made no difference whether the wrongful act was a conversion or a breach of contract. We cannot agree to that. We regard that as tending to undermine the thought (which should always be given prominence as *the* fundamental thought) that A has a property right, a right *in rem,* and not merely a contract right, a right *in personam.*

If A has nothing but a contract right, then such right is that B, whenever A is minded to sell, shall supply the stock (or other property) necessary to make a delivery. This scope of the right would be fatal to giving A the benefit of any market price between the date of the wrongful act and notice to A thereof, because his passivity in that period shows that he was not, during that period, minded to sell (and, even as to the value on the date of the wrongful act, he would have to proceed, not in assumpsit, but in indebitatus assumpsit for the *amount received by B*).

But if the rule in *Baker v. Drake* is a rule for measuring the damages for a *conversion* by B of A's pledgor interest our conclusion is that it is a good rule.

Consider first a conversion by a delivery made pursuant to an unauthorized sale.

Let it be assumed that A bought stock, and that the market price was 100; that a panic comes and the stock breaks to 80 and B without authority sells A's stock at 80 in January; that the market price then rallies and goes to 105 before February; then sinks again to 80 and is at 80 on May 1 when A first has notice; and that the highest market price within a reasonable time (say, thirty days) thereafter is 80. Under the *Salmon Weed* rule, in computing the damages the stock is valued at 80, and A's debt deducted.

This is not fair to A. All agree that the usual rule for valuing converted property is to take its " value " at the time of the conversion. But what was its " value " in January?

We distinguish, and distinguish sharply, between " market price " and " fair market value."

We have already (p. 146) defined " fair market value " and

repeat the definition: " Fair market value " is the amount in cash which would be agreed upon in a bargain between (a) a reasonably shrewd buyer who desires to buy and is able to pay in cash but is under no pressure to buy, and (b) a reasonably shrewd seller who desires to sell for cash but is under no pressure to sell.

If that is the sound definition, then obviously " market price " in a panic may be, and usually is, definitely below " fair market value," because a panic which carries prices down is due to the fact that there are sellers — usually many sellers — who are under substantial pressure to sell.

What is " fair market value " is a jury question. And surely the rebound market prices within a substantial period after the panic are relevant evidence. The great objection, the fatal objection, to the *Salmon Weed* rule is that all market prices between the date of the conversion and notice thereof are dismissed as irrelevant.

Ordinarily, " fair market value " is the *only* thing that should be considered; but, if A had no notice until some time later, another factor enters. All agree that A should be allowed to replace the stock within a reasonable time, and charge the cost to B. But as a practical matter few margin customers have the wherewithal to replace. An actual replacement is financially out of the question.

In *Markham v. Jaudon* Judge Grover said that when a person bought on a ten per cent margin he retained the other ninety per cent in his own pocket. Possibly, that was usually true in Judge Grover's time, but such a statement has been completely out of joint with the facts of business life for at least half a century. If a margin customer is sold out by his broker, in many cases he has little but experience with which to face the future. Attend the first meeting of creditors of a bankrupt stockbrokerage house (there has been at least one case where the number of customers was over ten thousand). If some attorney for the receiver should try to cheer up everybody by pointing out how favorable the law is to those who replace their securities by a second purchase, we venture to predict that he would be given a Bronx cheer.

It is therefore justifiable and commendable to put an A who

does not actually replace in as good a position as he would have been in if he had, in fact, made a replacement purchase within a reasonable time after notice. The objection-proof rule would be to take, not the highest market price, but the average market price in the replacement period.

The " replacement price," so determined, *may* be higher than the " fair market value " at the date of the conversion. If so, A should be given the benefit of that; B has no standing to object, — he has aggravated the wrong. Honest blunderers not infrequently convert, but at least they are aboveboard about it, make no attempt to keep it dark, and give notice to A forthwith; consequently in such cases there is no spread (or at least only a very slight spread) between the dates of B's conversion and the receipt by A of notice thereof. The spread comes only when B has not only done wrong but has also failed to tell A.

Therefore, if there were no other pertinent considerations, we should think that in determining the damages for a conversion, the property should be valued at its " fair market value " (as defined above) or at its " replacement value " (as defined above), whichever was higher.

Now, it is true that the new rule in *Baker v. Drake* is only a rough approximation to that. It takes the highest market *price* at any time between the date of the conversion and the expiration of a reasonable time after notice. B may object (1) that so long a period elapsed between conversion and notice that market prices in the latter part of that period are irrelevant; (2) that a market price in a reasonably long period after conversion is taken as *decisive* rather than as merely evidential (to be considered by the jury in conjunction with all other relevant evidence); and (3) that the average market price, rather than the highest market price, in the replacement period should control. We feel that there is force in all three objections.

On the other hand, it may fairly be said that the *Baker v. Drake* rule, is, at worst, only resolving doubts and difficulties of proof against the wrongdoer. This is the course that the law usually takes. Thus, if a jewel is tortiously extracted from a socket, then, in the absence of any evidence as to what the jewel was worth,

the jury will be told to presume the strongest against the tort-feasor "and make the value of the best jewel the measure of damages." *Armory v. Delamirie,* 1 Strange 505, (1722). See also the rule in cases of tortious confusion, where the goods of A and B have been mixed by B without the authority of A, and there is a difficulty in deciding how much came from each. *First National Bank v. Henry,* 159 Ala. 367, 376, 49 So. 97; *Mugge v. Jackson,* 53 Fla. 323, 326, 43 So. 91; *Maloney v. King,* 30 Mont. 158, 168, 76 Pac. 4; *Lance v. Butler,* 135 N. C. 419, 47 S. E. 488.

And there is something more to be said for the *Baker v. Drake* rule, as stated, which impresses us as of large importance. Is a rule easily administered? The application of the rule which we spell out above (fair market value or replacement value, whichever is the higher) would take much of the time of the courts. Juries might take a long time to agree. And there would almost certainly be a good deal of litigation over whether findings of juries as to the "fair market value" of stocks sold in a panic were, or were not, sustainable. Whereas, the *Baker v. Drake* rule, *as stated,* may most easily be applied. Market *prices* can easily be determined (indeed, most counsel are willing to stipulate what they were), and, once the market prices are known, the rest is routine.

Moreover, if the law is in such shape that it can be automatically applied (so that there is no chance at fuddling a jury), that has a tendency (slight perhaps, but certainly not negligible) to deter wrongful acts.

For these reasons, we have come after long consideration to the conclusion that it is good sense to let the *Baker v. Drake* rule, *as stated,* stand, unedited.

Theoretically, it is not a perfect rule; practically, it has some very strong points. While we do not contend that it is the most perfect rule imaginable, we are clear that, at least, it is better — much better — than the *Salmon Weed* rule.

That rule is not an improving edition of the *Baker v. Drake* rule. It *disembowels* the *Baker v. Drake* rule through depriving A of all advantage of rebound market prices.

It completely ignores what we believe is the most important consideration of all the pertinent considerations in a very large

number of cases. It makes B an involuntary purchaser, but *it allows him to purchase at panic prices.*

Should this measure of damages be applied in cases of tortious transfers to a second pledgee who acquires independent rights, thereby putting A's title in jeopardy?

We think that it is wise to keep the law simple, and to have one rule govern both cases. It is true that tortious sales are much more often made at a panic time than are tortious repledges. But if tortious repledges *are* made in a panic time, we see no reason why the *Baker v. Drake* rule should not apply. And, if they are not made in a panic time, the rule is quite all right, for in such cases there will be little, or no, spread between " market prices " and " fair market value."

The author's main point is that justice to A requires that " market prices " and " fair market value " should not be confounded, and that A should not be deprived of the benefit of rebound prices when the tortious transfer occurred at a panic time.

Stenton v. Jerome, 54 N. Y. 480 (1873)

A bought stock on margin through B, and agreed to keep good a specified margin upon demand and that on default B might close the account by a sale, either public or private, without notice. A's margin became impaired, and B sold, without demand for more margin, and without tender of the stock and demand of payment therefor. The court said *Markham v. Jaudon* established that the relation of pledgor and pledgee existed between A and B, and that the sale was unauthorized.

(The referee held that A was entitled to recover the balance of A's money in B's hands, excluding from the accounts the stocks in question. The court said that this rule of damages was " doubtless erroneous," but that as no complaint by exception or otherwise had been made to this at the trial, the judgment must be affirmed.)

Taussig v. Hart, 58 N. Y. 425 (1874)

B bought stock for A, and sold the certificate bought to X for B's own account. But at the time B had like stock of like amount. Later (March 17) he sold all such stock. This was held to be a

conversion. A " could ratify and claim the benefit of the sale, or claim the value of the shares on the day of sale " (p. 429).

B subsequently acquired like stock of like amount. The court in an opinion by Judge Rapallo said that this did *not* relieve B of liability for the tortious sale, and that " a personal claim against the broker . . . clearly is not what is contemplated under an agreement to buy and carry stocks. The customer does not rely upon an engagement of the broker to procure and furnish the shares when required, but upon his actually purchasing and holding the number of shares ordered, subject only to the payment of the purchase price " (p. 430).

He had previously said: " Whether the relation of pledgor and pledgee exists between a broker and his customers, or whether the broker holds the stock under a special contract, makes no difference in the result. The broker is in either case bound to keep at all times on hand or under his control, either the particular shares purchased for his customer, or an equal amount of other shares of the same kind, and to have them in such a situation that the customer, on paying the amount due by him thereon, can at any time obtain them " (p. 429).

There was another item. A had given an order to purchase certain stock. B had such stock and transferred it to A's account. The court held that A, on learning that fact, could repudiate the transaction. ". . . The law does not permit an agent employed to purchase, to buy of himself. It is no answer that the intention was honest and that the brokers did better for their principal by selling him their own stock than they could have done by going into the market. The rule is inflexible " (p. 428).

Comment:

B converted A's stock, and became liable for the full value of the stock on March 17. This was only one item in an account containing many others. If it had been the sole item, B would have been liable for the fair market value of the stock on March 17, less A's debt to B for the unpaid balance of the purchase price. It would have been a conversion of the pledgor's interest.

In *Wood v. Fisk* the transaction was not a tortious sale but was a tortious pledge. Our contention is that a tortious pledge to C

which gives C independent rights and therefore puts A's title in jeopardy is also a conversion, and that Judge Cardozo's distinction between a sale and such a tortious repledge is not justifiable.

We stress the point that in *Taussig v. Hart* the court held that the *subsequent* acquisition by B of like stock of like amount did *not* relieve B of his liability for the conversion made by a prior tortious transfer.

The restoration of the *status quo ante* did *not* wipe out B's liability for his tortious act. Then the thought of Judge Cardozo in *Wood v. Fisk* is wrong, unless there is justification for making one rule where the tortious transfer is a sale, and the opposite rule where the tortious transfer is a pledge.

Wicks v. Hatch, 62 N. Y. 535 (1875)

A constituted X her agent. Acting within his authority, X instructed B to purchase stocks and gold and authorized B at B's discretion to sell "at public or private sale, without any notice whatever, the stocks or gold which [B] might be carrying for [A] whenever the margin should fall below five per cent" (p. 537). The margin did fall below that point and B sold, without notice, at a brokers' board. The court held that this was an authorized liquidating sale, and that A had no cause for complaint.

Ogden v. Lathrop, 65 N. Y. 158 (1875)

A authorized B to use, transfer, or hypothecate the stock purchased for A's account, B being under an obligation "on payment or tender at the proper time of the amount loaned and interest, to return an equal quantity of said security, and not the specific stock deposited . . ." (p. 159). B sold. The court held that the sale was authorized, and that B's obligation was only to return a like amount of like stock.

Comment:

The terms of the contract made by A and B controlled. There was no public policy against such a contract. We submit that this case is to be *contrasted* with *Wood v. Fisk* where a repledge was made in violation of the express terms of the contract between A and B.

Baker v. Drake, 66 N. Y. 518, 23 Am. Rep. 80 (1876)

B sold securities bought for the account of A, after A had failed to meet a margin call. The sale was made on the New York Stock Exchange without notice to A. A sued for a conversion. B offered in evidence a letter from A to B in which A said that transactions for his account should be ". . . in every way subject to the usages of your office" (p. 519). B offered to prove that at the pertinent dates it was the custom of their office in such a case to sell on the New York Stock Exchange without giving notice to the customer of the time or place of the sale. The trial judge rejected the offered testimony, and the chief contest was as to whether this rejection was error.

Six judges heard the oral argument and they divided on this three to three. The seventh judge (Judge Folger) was consulted, and he thought that the rejection was error. The judgment below was therefore reversed by a vote of four to three, and a new trial ordered.

Judge Folger wrote a brief, lucid opinion which is very helpful in showing what the New York law then was.

By a majority of five to two the court adhered to the decision of *Markham v. Jaudon* (our pp. 260–262) on three points:

First, that the relation of broker and customer, under the ordinary contract for a speculative purchase of stocks, is that of pledgee and pledgor. Second, that a sale of the stock by the broker, under such a contract, without notice to the customer of the time and place of sale, is a *conversion.* Third, that oral proof of the usage of brokers in such cases is *not* admissible, to add to or make part of the contract. The five were Church, Ch.J., and Folger, Andrews, Miller and Earl, JJ. The two were Allen and Rapallo, JJ.

The court was unanimous that the parties might provide by contract for any manner of disposing of the pledge to satisfy the debt which was not in contravention of a statute, or against public policy, or fraudulent.

Was *oral* proof of "usages" competent in the case at bar? The majority (four to three) held that it was. "The word 'usages' meant the habits, mode and course of dealing in the office of the

defendant. If, instead of this word, those habits, modes and course of dealing had been set forth at length in the instrument, would not the transactions of the plaintiff and defendants in stocks, under the directions of Rogers, have been subject to them, subject to the rules of law? As they were not so set forth, the word 'usages,' alone, does not convey the full meaning of the parties to the instrument, and a court may not, from a perusal of the paper, know all that was in their contemplation. There is need of parol proof to enable the word used by them to convey the full meaning with which they meant to charge it. And parol proof is competent therefor. If parol proof should show that it was a usage of the defendant's office, for want of margin, to sell stocks in pledge at the public board of brokers, without notice to the pledgor of time or place of sale, would it not tend to establish an agreement by the plaintiff, that the same course might be taken in his case? To so agree would not have contravened any statute, nor infringed upon public policy, and it might not have been fraudulent" (p. 523).

As to damages, the trial judge had charged that A was entitled to recover as damages ". . . what it would have cost him to replace the stocks on a day within a reasonable time after the sale, deducting the sum due to [B], and the recovery was based on the market value of the stock, on a day between the sale and the commencement of the action" (p. 524). A took no exception to this. B did except, but the court said B had no ground for exception.

Comment:

The thoughts of the author are in perfect harmony with the thoughts of the majority on all points. (1) The relation between A and B is that of pledgor and pledgee, — the customer has property rights and not merely contract rights; (2) liquidating sales are, apart from a contract to the contrary, authorized only on compliance with all the conditions imposed by the common law (our pp. 188–190); (3) any "custom of the street" which is contrary to the common law is, apart from contract, irrelevant; (4) but A may, if he sees fit, agree that the sale may be made according to the "usages" of any particular B in the conduct of his busi-

ness; and (5) where the word "usages" is used in a *written* contract, *oral* evidence is admissible to show what those usages were.

We stress the fact that all seven judges took it in their stride that a pledgor could sue for the *conversion* of the *pledgor's interest* even though he did not have the right to immediate possession of the pledge at the conclusion of the act complained of (see our pp. 152–159).

The practising lawyer may find it profitable to examine the powerful briefs of James C. Carter, Esquire, counsel for B in the two *Baker v. Drake* cases.

Smith v. Hall, 67 N. Y. 48 (1876)

A pledged $3,000 in bonds to B to secure debt number 1. A made a tender and demand and B refused to surrender, claiming that the pledge was to secure debts numbers 1 *and* 2. A sued B for the conversion of the bonds. The trial judge charged that if the jury found certain facts, A was entitled to recover from B $3,000 less the amount of debt number 1. No error.

The trial judge had also ruled that the action was for a conversion, not for a breach of contract. No error.

The court in an opinion by Judge Rapallo said: "The case of *Austin v. Rawdon* (44 N. Y. 63) relied upon by the appellant to show that this was an action on contract is not an authority in his favor on that point. That action was founded on an agreement by the defendants to deliver certain securities. The allegation that the refusal to deliver them was wrongful, and that the defendants wrongfully disposed of and converted them, did not make it an action of tort. All these acts were simply a violation of their contract. In the present case the right of the plaintiff to the bonds is founded upon his own title and not upon any promise of the defendant. The wrong done is the conversion of *his* property, not the mere breach of an agreement to deliver property to him" (p. 51).

Comment:

Note that here Judge Rapallo accepts the doctrine that the wrongful act was a conversion, and not merely a breach of contract.

JAMES C. CARTER

A leader in his time of the New York bar

Merchants' Bank v. Livingston, 74 N. Y. 223 (1878)

This case is to be contrasted with *McNeil v. Tenth National Bank* given at p. 263. The delivery of a blank transfer of a certificate of stock with irrevocable power of attorney to transfer, signed by the person who appears by the certificate to be the owner, does not, *without more,* confer upon the person to whom it is delivered apparent authority to the transferee to act as agent for the owner to pledge the stock.

Hennequin v. Clews, 77 N. Y. 427, 33 Am. Rep. 641 (1879)

A pledged bonds to B, as security for a letter of credit. B repledged to C. Conflicting claims were made as to B's authority to repledge, but the court said that it would assume that B ". . . held the bonds as pledgee, with no other rights in respect to them, than such as that relation entitled him to, and that the hypothecation or sale was wrongful, *and entitled* [*A*] *to an action for conversion*" (p. 429; italics supplied).

B had been discharged in bankruptcy. Did this discharge release him from liability for the conversion? This turned on whether a claim grounded on such a wrong was excepted from the operation of the discharge under that section of the Bankruptcy Act of 1867 which corresponded to Section 17 of the Bankruptcy Act of 1898 (our pp. 215–216). The court held that it was not excepted. Therefore an order of arrest was vacated.

Comment:

The court proceeded on the conception that *a tortious repledge* by a pledgee *is a conversion.*

This case was not mentioned in *Wood v. Fisk.* See p. 230.

Fishkill Savings Institution v. Fishkill National Bank, 80 N. Y. 162, 36 Am. Rep. 595 (1880)

X was both the treasurer of A (the Savings Bank) and cashier of B (the National Bank). X took A's bonds, and, as agent of B, pledged them to C to secure advances by C to B. The bonds were thereafter lawfully sold by C. In an action for conversion by A against B, B was held liable for that tortious act of X.

Comment:

This is not a case of pledge by A to B, and is inserted only because of a dictum. Prior to the transaction in question X had done the same thing before. But the first time he had later repossessed himself of the bonds by substituting with the pledgee other security not belonging to A. The court remarked: ". . . it is obvious that although a conversion had taken place, for which an action might then have been maintained, the recovery would have been nominal" (p. 166).

Does this furnish any justification for Judge Cardozo's nominal damages for a "technical" conversion? No. There had been a conversion (nothing "technical" about it) but the converted bonds had been voluntarily taken back by A, acting through its agent X. A voluntary acceptance of converted property may always be shown in mitigation of damages. See Appendix B.

Gruman v. Smith, 81 N. Y. 25 (1880)

B purchased stock on A's account, a margin call was not met, and B sold without notice to A. The proceeds of the sale were less than A's debt and B brought suit against A for the deficiency. The trial court held that the tortious sale extinguished B's right *in personam* against A and dismissed the complaint. This, of course, was error (see our p. 290), and the judgment was reversed and a new trial granted.

Some language was used by Chief Judge Church which made for confusion. He said that the sale ". . . although irregular, and technically amounting to a conversion . . ." (p. 27), and so forth. In another place he said: "This rendered the sale irregular, and constituted a conversion" (p. 28).

Those who are interested to justify or excuse Judge Cardozo are justified in saying that he was not the first to speak of a technical conversion even in pledge cases.

Chief Judge Church also made a dictum as to the measure of damages. He said that A was entitled to a reasonable time after *notice* of the sale to replace the stock, and if during that time it had advanced in price, he would have been entitled to the difference. *Baker v. Drake.* Beyond this he was not legally injured.

But in another place he said that the relation of the parties was that of pledgor and pledgee and that *Baker v. Drake* had left *Markham v. Jaudon* undisturbed except as to the rule of damages.

He seems to have been unconscious that he was stating a different rule of damages from that stated in *Baker v. Drake*. According to that case the highest-intermediate-value period started from the time of the tortious sale. But according to Chief Judge Church it starts, not at the time of the sale, but at notice to A of the sale. See our pp. 269–273.

Capron v. Thompson, 86 N. Y. 418 (1881)

B purchased stock for A's account, and tortiously pledged it to C who thereafter made an *un*authorized liquidating sale. B never tendered similar stock to A and never demanded payment of the amount due. He sued for the deficiency. In an action for an accounting, the court held that B was entitled to a credit for the purchase price, although he might be liable for the conversion constituted by the tortious pledge. The court cited *Gruman v. Smith* (our p. 280), quoted from the opinion in that case (" The relation of the parties was that of pledgor and pledgee. For a *conversion* (italics supplied) of the pledge the pledgee was liable for the damages sustained by the defendant, but whether they would equal the amount of the claim would depend upon the facts developed "), and said: " The principle upheld is applicable to the case at bar, and we are unable to discover any distinction between the two cases " (p. 421).

Comment:

In *Gruman v. Smith* the tortious act by B was a sale, and in the case at bar it was a pledge. The court was " unable to discover any difference between the two cases." Therefore in *both* cases there was a *conversion* by B.

Not a word about this authority in *Wood v. Fisk*. See p. 230.

Colt v. Owens, 90 N. Y. 368 (1882)

The court assumed that B had made an unauthorized sale of stock bought for A's account. The fact was that A could have purchased similar stock within a reasonable time after notice of

the sale at no more than the price at which it had been sold. The trial judge had directed a verdict for six cents damages and six cents costs. No error.

Comment:

If the action was for a breach of contract then judgment should be for A with nominal damages and costs. If the action was for a conversion, then the judgment should have been for defendant with costs.

But nobody was fussing about the difference between "Judgment for the plaintiff for nominal damages," and "Judgment for the defendant."

Wyckoff v. Anthony, 90 N. Y. 442 (1882)

When securities are pledged to a banker or broker for the payment of a particular debt, the pledgee is not entitled to treat the pledge as security for a general balance, or other claims. Where tender is made shortly before the maturity of the debt and both A and B treat the debt as matured, the tender is valid.

Comment:

This was an action for a conversion of a pledgor's interest. No one questioned but that such an action lay, *if* A had tendered the proper amount at a proper time. If so, there would have been a conversion of the pledgor's interest by a tortious *withholding.*

Farwell v. Importers' Bank, 90 N. Y. 483 (1882)

A gave a promissory note indorsed in blank to B, a broker, to sell. B tortiously pledged it with some other collateral (which B owned himself) to C, a bona fide pledgee. A notified C of his claim, but paid the note to C when due. Later, C realized enough from the other collateral to satisfy its claim. Then, in equity, A is entitled to recover back from C what he had paid C.

The court said: "There can be no doubt that [B was] guilty of a conversion of [A's] note" (p. 488).

Comment:

This was not a tortious sale by B, but a tortious pledge by B to C, who acquired independent rights. The court thought that

there could be no doubt that such an act was a conversion. A third pertinent case of which not a word in *Wood v. Fisk.* See p. 230.

Talmage v. Third National Bank, 91 N. Y. 531 (1883)

This case is to be compared with *McNeil v. Tenth National Bank* (p. 263). There had been a verdict for A and on the facts there was evidence justifying a finding that C knew that B had no authority from A to pledge A's stocks to C for more than $35,000. A tendered to C $35,000 and interest. C refused. Then A tendered $46,000. Again C refused. Judgment for A for the value of the stocks less $35,000. The tender of the $46,000 was made with a view of arranging the controversy without litigation and was not conclusive upon A as an admission that B had so large a pledge interest.

Comment:

Nobody thought of questioning A's right to recover *if* a proper tender had been made. There was a conversion through a tortious withholding (see pp. 166–184) and A was suing for the value of the pledgor's interest, and was entitled to recover it.

Stratford v. Jones, 97 N. Y. 586 (1885)

B bought stock for A's account. Later, B tortiously sold it, and failed the same day. Still later, B went into bankruptcy and received a discharge. A proved his claim in the bankruptcy proceedings, and then sued B for conversion of the stock. A contended that the sale by B when about to fail was a fraud, and was excepted from the operation of the discharge by a provision in the Bankruptcy Act of 1898 (see our pp. 215–220).

Judgment for B. The opinion was by Judge Rapallo: "The unauthorized sale of the stock was a *conversion,* but did not constitute such a fraud as is contemplated by the Bankrupt Act" (p. 589).

Comment:

On the second appeal of *Baker v. Drake* (p. 276) Judge Rapallo was one of the two judges out of seven who had held out for the view of the dissenting judges in *Markham v. Jaudon* that

B was not pledgee but owner. Now, however, he apparently thinks he should acquiesce in the opinion of the majority and that the law should be treated as settled in accordance with that opinion. Of course if B is the owner his sale is not a conversion of A's property.

Wright v. Bank of the Metropolis, 110 N. Y. 237, 18 N. E. 79, 1 L. R. A. 289, 6 Am. St. Rep. 356 (1888)

The headnote on the case was as follows:

Where a pledgee of corporate stock, acting in good faith and under an honest mistake, converts it by an unauthorized sale thereof and refuses to replace it on demand, it is the duty of the owner to replace it himself within a reasonable time after notice of sale, and the proper measure of damages for the conversion is the highest market-price during such reasonable time. The rule in this respect is the same, whether the pledgee is a broker, who purchased and was carrying the stock on a margin for a customer, or whether the owner had paid in full for the same and was holding it as an investment. What is a reasonable time is, where the facts are undisputed, a question of law for the court.

The opinion was written by Judge Peckham. What damages would naturally be sustained by the plaintiff in restoring himself to the position he had been in; or, in other words, in repurchasing the stock? He said: "It is assumed in the opinion that the sale by the defendants was illegal and a *conversion*, and that plaintiff had a right to disaffirm the sale and to require defendants to replace the stock. If they failed, then the learned judge says the plaintiff's remedy was to do it himself, and to charge the defendants with the loss necessarily sustained by him in doing so. Is not this equally the duty of a plaintiff who owns the whole of the stock that has been wrongfully sold? I mean, of course, to exclude all question of punitive damages resting on bad faith. In the one case the plaintiff has a valid contract with the broker to hold the stock, and the broker violates it and sells the stock. The duty of the broker is to replace it at once upon the demand of the plaintiff. In case he does not, it is the duty of the plaintiff to repurchase it. Why should not the same duty rest upon a plain-

tiff who has paid in full for his stock and has deposited it with another conditionally? The broker who purchased it on a margin for the plaintiff violates his *contract* and his duty when he wrongfully sells the stock, just as much as if the whole purchase price had been paid by the plaintiff. His duty is in each case to replace the stock upon demand, and in case he fails to do so, then the duty of the plaintiff springs up, and he should repurchase the stock himself. This duty, it seems to me, is founded upon the general duty which one owes to another, who *converts* his property under an honest mistake, to render the resulting damage as light as it may be reasonably within his power to do. It is well said by Earl, J., in *Parsons v. Sutton* (66 N. Y. 92) that ' the party who suffers from breach of *contract* must so act as to make his damages as small as he reasonably can. He must not by inattention, want of care or inexcusable negligence permit his damage to grow and then charge it all to the other party. The law gives him all the redress he should have by indemnifying him for the damage which he necessarily sustains.' See, also, *Dillon v. Anderson* (43 N. Y. 231); *Hogle v. New York Central & Hudson River Railroad Company* (28 Hun 363), the latter case being an action of tort. *In such a case as this, whether the action sounds in tort or is based altogether upon contract, the rule of damages is the same.* (Per Denio, Ch. J. in *Scott v. Rogers,* 31 N. Y. 676; and per Rapallo, J., in *Baker v. Drake, supra.*)

" The defendant's liability rests upon the ground that he has *converted,* though in good faith and under a mistake as to his rights, the property of the plaintiff. The defendant is, therefore, liable to respond in damages for the value. But the duty of the plaintiff to make the damages as light as he reasonably may, rests upon him in both cases, for there is no legal wrong done by the defendant in selling the stock, which the plaintiff has fully paid for, than there is in selling the stock which he has agreed to hold on a margin, and which agreement he violates by selling it " (p. 244; italics supplied).

Comment:

Judge Peckham goes back and forth from conversion to breach of contract as though the two terms were synonymous, which, we

submit, they are not; and states that the rule of damages should be the same for a conversion as for a breach of contract which, we submit, is not sound (see our pp. 139–147).

He also seems unconscious that there may be an important difference between beginning the highest-intermediate-value period with the time of the tortious act, as contrasted with the time of the notice to A of such tortious act (see our pp. 269–273).

Thompson v. St. Nicholas Bank, 113 N. Y. 325, 21 N. E. 57 (1889)

A delivered bonds to B, to be held to secure amounts due from A to B on purchases of stock. B tortiously pledged to C to secure any indebtedness, past or present, of B to C. C certified checks drawn by B on C, and paid such checks. The certification was on the facts in violation of the National Banking Act.

Held, nevertheless, that B became indebted to C for the amount of the checks, and that A had no right against C to the possession of the bonds unless prior to the commencement of the action A paid or tendered to C the amount of B's debt to C.

Comment:

C had independent rights owing to the nature of the property pledged by B to C (see p. 22, and *McNeil v. Tenth National Bank,* p. 263).

There was no penalty for an unauthorized certification *beyond* that provided by the National Banking Act, and the unauthorized certification did not prevent C from being a bona fide pledgee.

Knickerbocker v. Gould, 115 N. Y. 533, 22 N. E. 573 (1889)

B made a liquidating sale of stocks purchased for account of A. A testified that he understood he was not to be responsible for any deficiency, but did not show that this was part of the contract between A and B. A directed verdict for B was not error.

Caswell v. Putnam, 120 N. Y. 153, 24 N. E. 287 (1890)

The fungible character of stock was recognized. B's duty was only to keep in his possession or under his control like stock of a like amount. Where B was imposed upon by X, who alleged

he was agent of A, and made numerous purchases and sales at X's direction, A was not entitled to ratify a single purchase and sale and claim the benefit thereof.

Gillett v. Whiting, 120 N. Y. 402, 24 N. E. 790 (1890)

B sued A for a deficiency. At the trial the court was requested to charge that, if B sold the stock without notice to A as to the time and place of the sale, B violated his duty to A and converted the stock. This request was refused. Held, error; that the relation between A and B was that of pledgor and pledgee and if B sold without demanding additional margin, or giving reasonable notice that a sale would be made, the sale was a conversion.

The court further said that this tortious sale did not simply entitle A to a reduction of damages, but barred B from bringing any action.

The judgment was reversed and a new trial granted.

Comment:

The court was clear that the tortious sale was a conversion.

Suppose the value of the stock ascertained under the *Baker v. Drake* rule is less than the debt. In such case the doctrine of the court is that B has forfeited his right *in personam* against A for the balance.

This, we submit, cannot be justified. The law in New York at this time was clear that by the conversion B did not forfeit the pledge right *in rem*. That is the very essence of the modern law of pledge. Then, *a fortiori*, the conversion ought not to forfeit the pledgee's right *in personam*. This case has not been law since *Minor v. Beveridge*, p. 290.

De Cordova v. Barnum, 130 N. Y. 615, 29 N. E. 1099, 27 Am. St. Rep. 538 (1892)

A deposited with B stock (No. 1) owned by A as additional security for the amount due from A to B on other stocks purchased on margin (No. 2). B then sold stocks No. 2 pursuant to A's order, and brought action for a deficiency. Held, B was not obliged to realize upon stock No. 1 before bringing such action, there having been no agreement between A and B to that effect.

Williams v. United States Trust Co., 133 N. Y. 660, 31 N. E. 29 (1892)

A sale without notice is lawful if A authorized such a sale, and there had been no modification of the agreement.

Gillett v. Whiting, 141 N. Y. 71, 35 N. E. 939, 38 Am. St. Rep. 762 (1894)

On a previous appeal (our p. 287) the court had held that B by making an unauthorized sale had forfeited his right *in personam.* In an opinion written by Judge Finch the court said that it was urged that, in so doing, the court: ". . . disregarded earlier decisions to the contrary, disturbed a settled doctrine, and left it impossible to reconcile the cases," and said that it would ". . . certainly try to clear the doctrine of its difficulties and end the supposed collision of authorities when the fit occasion comes. . ." (p. 73).

But the consideration of that question was not necessary for, on the second trial, B claimed that A ratified the unauthorized sale and the jury found for B. There was evidence to sustain the verdict.

The trial court had refused ". . . to charge that, 'to make the defendant liable for a ratification of an unlawful sale, it must appear to the satisfaction of the jury that he knew his legal rights.'" As to this, the court said: "What rights were referred to, or how the plaintiff was to prove the extent of defendant's legal knowledge, we are not told, nor why the latter, instead of asserting ignorance, explicitly declared that he knew plaintiff had violated his contract by selling his, defendant's, property. No ground existed for such a charge, even if in any conceivable case it should be justified. It cannot be necessary to argue seriously that there was no error in the court's refusal" (p. 76).

Smith v. Savin, 141 N. Y. 315, 36 N. E. 338 (1894)

A had prior to May 8, 1884 often employed B as banker and broker. On that date, B had in his possession a certificate for 100 shares of Missouri Pacific stock, and a power of attorney to transfer on a detached sheet. This power had not been acknowl-

edged by the transferor, and therefore under the rules of the New York Stock Exchange the certificate, plus such transfer power, was not a good delivery. This stock belonged to A and had been deposited with B as security. But it so happened that on that date A owed B nothing.

On May 8, B borrowed $50,000 from C, pledging the Missouri Pacific stock and also other stocks which were owned by B. On May 14, 1884 (the day of the Grant & Ward failure) B assigned to X for the benefit of his creditors. A then learned that B had pledged his Missouri Pacific stock to C, and A immediately went to C and informed him of his interest. A met with a chilly reception. C refused to recognize A's rights in the stock and refused to give him any information about C's claims therein. C apparently lost his head and proceeded to make a liquidating sale on the New York Stock Exchange, without making proper demand or giving notice of the sale either to B or A. B owed C $50,000 and interest; all the collateral sold for about $3,000 more than B's debt. The Missouri Pacific sold for about $8,000. A had no notice of this sale until June 21, 1884 by which time the market value of 100 shares of Missouri Pacific had risen to $10,000. The market value of the other collateral had also risen, and if C had not sold until June 4 the other collateral could then have been sold for enough to pay B's debt to C. What were the rights of the parties?

It was contended that C was not a bona fide pledgee because the power of attorney to transfer was not acknowledged. But the court was not impressed. This defect was wholly immaterial for the purpose of charging C with notice of any defect in the title of B. C was a bona fide pledgee.

But, as soon as A notified C of his rights it became the duty of C to sell the other securities before resorting to the Missouri Pacific stock. C had, however, obtained full value and the court held that therefore A had no claim against C except with reference to the Missouri Pacific stock.

The unauthorized sale was a conversion of A's interest in the stock above the amount needed to complete the payment of B's debt to C, after applying the proceeds of the other securities. The

debt was $50,000, the other securities sold for $45,000. Therefore A was entitled as against C to the value of 100 shares of Missouri Pacific less $5,000.

But as of what date is the Missouri Pacific to be valued? A had the right to ". . . the highest price which his stock reached within a reasonable time after its illegal sale by [C] " (p. 327). Judge Peckham said: " I should say that in general the time elapsing between the 14th of May and the 21st of the following June was much more than a reasonable time in which to purchase back stock of this kind when it had been illegally sold, but the fact appears that the plaintiff was not aware of such sale until about near the latter date, and in such case the time allowed to take the highest price is of course not unreasonable " (p. 327).

Comment:

A was allowed to value the stock as of about the time when he had notice of the sale. The question whether he might have taken advantage of an even higher price between May 14 and June 21 was not presented.

Minor v. Beveridge, 141 N. Y. 399, 36 N. E. 404, 38 Am. St. Rep. 804 (1894)

B, by an unauthorized sale, does not forfeit his right *in personam* against A. The court distinguished *Gillett v. Whiting,* 120 N. Y. 402, 24 N. E. 790, our p. 287, and said that, on the record, the remarks of the court in that case as to the effect of B's conversion upon B's cause of action against A on the debt were *obiter.*

In another place, the court spoke of ". . . the settled law of this court that even where a stock broker sells without due notice stock purchased by him for a customer, on a margin, and held in pledge to secure the advance made by him for the purchase, he does not thereby, as a matter of law, extinguish all claim against the customer for the advance, but the customer is entitled to be allowed as damages the difference between the price for which the stock sold and for which he received credit, and its market price then, or within such reasonable time after notice of sale as would have enabled him to replace the stock in case the market price exceeded the price realized " (p. 403).


Samuel H. Gottscho, Jamaica, N.Y.

THE NEW YORK STOCK EXCHANGE

Comment:

Since this case the New York law has been clear that a conversion of the pledge, the supporting right *in rem,* does not forfeit the debt, the right *in personam.*

Hatch v. National Bank, 147 N. Y. 184, 41 N. E. 403 (1895)

The proceeds of A's stock tortiously obtained by B were deposited by B with C, a bank. By agreement between B and C, C had authority to use deposits by B to discharge debts owed by B to C. C, after notice of B's failure, so applied it. A had no cause for complaint against C. The failure of B did not affect C with notice that the deposit was of money improperly obtained.

Le Marchant v. Moore, 150 N. Y. 209, 44 N. E. 770 (1896)

A directed X to purchase stock for A's account. X purchased through B, not disclosing A. X notified A of the purchase. Thereby A became owner of the stock. X failed, and A notified B of his interest. A was entitled as against B to have other securities for X's debt first applied, and then to recover from B the surplus. B paid the surplus to the assignees of X. This was wrong and A was entitled to recover from B the amount of such surplus.

Franklin National Bank v. Newcombe, 1 App. Div. 294, 37 N. Y. S. 271 (1896) affirmed without opinion 157 N. Y. 699, 51 N. E. 1090 (1898)

A borrowed from B, giving a note payable at a specified date, and secured by pledge. B was authorized to sell upon default at any brokers' board or at public or private sale, without advertisement or notice, and to purchase himself at such sale free from any equity of redemption. The note matured, there was default, and B without making a demand sold two weeks after default and purchased himself. A charged that the sale was at a sacrifice price. Held, that B had a right to sell without waiting for a favorable condition of the market, and without demand. There was a dictum that if the note had been a demand note, a demand would have been necessary.

Kennedy v. Budd, 5 App. Div. 140, 39 N. Y. S. 81 (1896)

Where B purchases stock for A on margin, the Statute of Limitations on B's claim against A for balance of the purchase price does not begin to run at the date of each purchase.

Deitz v. Field, 10 App. Div. 425, 41 N. Y. S. 1087 (1896)

One cannot sue for a conversion of securities, and, after a recovery in such action, sue to recover possession of the securities.

Douglas v. Carpenter, 17 App. Div. 329, 45 N. Y. S. 219 (1897)

See our pp. 220–225.

Matter of Pierson, 19 App. Div. 478, 46 N. Y. S. 557 (1897)

Firm creditors, after obtaining the proceeds of specific stocks purchased for them, may recover against an individual partner for their *conversion* by a tortious *pledge*. Not mentioned in *Wood v. Fisk.*

McCutcheon v. Dittman, 23 App. Div. 285, 48 N. Y. S. 360 (1897), modified 164 N. Y. 355, 58 N. E. 97 (1900)

The rule requiring a pledgee to give the pledgor notice before selling the pledge is not complied with where the only notice given consists of a newspaper clipping, mailed to the pledgor by the pledgee's attorney, in which auctioneers give public notice that, at their regular sale of securities held on a day stated, they will sell, "for account of whom it may concern," a long list of stocks and other securities, including those pledged, which are described merely as "53 shrs. United States Printing Co.," the notice being marked with lead pencil or ink marks opposite the item in question.

The fact that the attorney for the pledgee was also the attorney for the purchasers of the pledge at the auction sale (in a prior proceeding in which the pledge was attached in the hands of the pledgee for a debt due to such purchasers) does not operate to charge such purchasers with the knowledge of the attorney as to the circumstances under which the sale was made, where there is no evidence that the attorney had any communication with them in reference to their becoming purchasers at, or acted as their attorney in any way in connection with, the sale.

Adams v. Ball, 24 App. Div. 69, 48 N. Y. S. 778 (1897)

The owner of stocks who has pledged them for an unpaid portion of their purchase price is entitled, where such stocks have passed into the hands of the general assignee of the pledgee and have been sold by him, to an injunction, in an action brought by such owner against the assignee to recover the proceeds of the sale over and above the unpaid purchase price, restraining the assignee from paying out such proceeds to preferred creditors of the assignor, to the exhaustion of the entire assets of the pledgee, as such an act on the part of the assignee would, within the meaning of section 640 of the Code of Civil Procedure, tend to render the judgment demanded by the pledgor ineffectual.

Robinson v. Crawford, 31 App. Div. 228, 52 N. Y. S. 560 (1898)

Brokers who have purchased merchandise for a customer on speculation, and who, when the margin became insufficient to protect the purchase, have sold the same without notice to the customer, may, in an action brought by them to recover a loss resulting from such sale, show, in vindication of their right to make such sale, the habitual course of dealings between the parties respecting contracts and transactions of that especial kind, in particular a memorandum sent to the customer similar to others sent to him on the occasion of previous purchases, which contained the following provisions: "It is further understood that, on all marginal business, the right is reserved to close transactions at our discretion when margins are near exhaustion, without further notice."

Rhinelander v. National City Bank, 36 App. Div. 11, 55 N. Y. S. 229 (1898)

In marshaling the claims of an assignee and three other parties to a balance arising from the sale of securities by a bank, to which they had been pledged for an indebtedness by a firm which afterwards made an assignment for the benefit of its creditors, the claim of one of the parties, other than the assignee, based upon the fact that he was the absolute owner of certain of the stocks, unincumbered by any lien in favor of the firm, which held them merely on deposit for sale and until sold for safekeeping, cannot be said to

be superior to that of the other two claimants whose stock was held by the firm as pledgee, where it appears that, upon the failure of the firm, all that was due to it from the two latter claimants was duly tendered, and that neither the firm nor its assignee could deliver the specific shares or an equivalent number; as, upon the tender, demand and refusal the pledgee's right to the securities was lost, and, as they were released from the lien of the pledge, their proceeds in the hands of the bank were also released from any claim of the pledgee firm.

In such a case the three parties stand in equality of right, the fund is distributable among them proportionately, and the assignee takes nothing.

Griggs v. Day, 158 N. Y. 1, 52 N. E. 692 (1899)

A, a contractor for the construction of a railroad, X, received the promissory notes of X, and pledged them to B, the promoter, to secure a debt of A to B. B surrendered the notes to X, valuing them according to their face value. In an accounting between A and B, A should be credited with the face value of the notes surrendered to X. This credit extinguished A's debt to B.

The debt of A to B having been thus extinguished, B retained other security given for A's debt to B and thereby prevented A from participating in the reorganization of X. A is entitled to the benefits he would have gained by participating in such reorganization. If A had participated, he would have received new stock by paying $35 a share. This stock subsequently sold at $63.625 a share. The difference between $35 and $63.625 was therefore $28.625 a share and this multiplied by the number of shares involved amounted to $348,394.87. But the court held that although the successor of B had no answer based on the thought that A did not have the wherewithal to participate in the reorganization, nevertheless it was A's duty to act within a reasonable time, and that there was no evidence that such stock was worth more than $35 within a reasonable time and that consequently the damages (on this item) should be only nominal.

Comment:

B improperly withheld stock from A. If that wrongful act was

viewed as breach of contract the measure of damages would be nominal; if viewed as a conversion, there would be no damages because there was no evidence that the stock within a reasonable time thereafter had any value over the reorganization subscription price. Therefore there was nothing to fight about except the difference between nominal damages and nil, and nobody was fussing about that.

Gillet v. Bank of America, 160 N. Y. 549, 55 N. E. 292 (1899)

A borrowed $35,000 from B, a bank, on pledge. A agreed that B might hold the pledge as security for the payment of such loan and also for " any other liability or liabilities of [A] to [B], due or to become due, or which may hereafter be contracted or existing . . ." (p. 552).

Later, X held a note of A for $5,000. It was payable at B. It was presented by X and was dishonored. Subsequently B purchased this note from X (at a price not stated). The question was whether B was entitled to hold the pledge as security for the $5,000 (as well as the $35,000).

Held, " No." If B had paid the note, " Yes "; but B dishonored the note, then bought it.

The court said: " To hold that by the language of this agreement the parties contemplated giving security to the defendant for any and all claims which it might purchase, would be to extend the security to all the outstanding debts of the assignors which the defendant might have the ability and be willing to buy. That the parties intended any such effect by the words employed, we do not believe. Their minds never met upon a provision which would include any such outside transactions, and no such result could have been intended " (p. 559).

Toplitz v. Bauer, 161 N. Y. 325, 55 N. E. 1059 (1900)

Where the original contract, under which a policy of life insurance is pledged as collateral security for the payment of a promissory note, permits a sale, public or private or otherwise, or a surrender of the policy to the company issuing it, without notice to the pledgor, the right of the pledgee to so dispose of it upon de-

fault in payment of the note, may be waived by any agreement, declaration or course of conduct on his part which leads the pledgor to believe that a forfeiture will not be insisted upon without an opportunity given him to redeem, and no new or independent consideration is required to support the waiver; and if, having waived his right to a strict performance of the contract, the pledgee surrenders the policy to the company, without notice, he is liable for the damages occasioned thereby in an action of conversion; and in such an action, the plaintiff is not obliged to show affirmatively that he could have raised the money to pay the debt at the time of the conversion if notice had been given.

It seems, the rule of damages to be applied in such a case would be the cost of replacing the policy on the same terms in a perfectly sound company at the time of the surrender; but where it appears that at that time the insured was suffering from a fatal disease, from which he subsequently died; and that he had ceased to be an insurable risk, and the company, having cancelled the obligation, refused to reinstate it, the damages are the face value of the policy, less what it would have cost to carry it by payment of another premium, which fell due before the death of the insured, with interest from the date of conversion.

Usher v. Van Vranken, 48 App. Div. 413, 63 N. Y. S. 104 (1900)

A alleged that he gave a note to B, secured by pledge of the stock of X, that B sold and delivered the note and pledge to C, that C sold the pledge (but not the note) to D, that D sold the pledge to E, and that D and E had knowledge of A's rights, and that such transfers were made to enable E to obtain control of X. Held, that the complaint stated a cause of action in conversion against E; and that as E had not acquired possession of the stock lawfully, it was not necessary for A to allege demand and refusal.

Comment:

In New York, C, a bona fide purchaser of the property of A from B who has no authority to sell, is not, without more, a converter. See *Peese v. Smith,* our p. 137 and note 36.

Demand is necessary only in the *second* species of conversion — a tortious withholding (p. 118).

Brady v. Mount Morris Bank, 65 App. Div. 212, 73 N. Y. S. 532 (1901)

A bank which obtains as security for a loan made to its cashier a certificate of stock, indorsed in blank by the owner and left with the cashier, without notice of any infirmity in his title to the certificate, obtains a good title thereto as against the person to whom the certificate was originally issued and who claimed to have lost the same.

Knowledge upon the part of the cashier that he was without authority to pledge the stock is not chargeable to the bank, as in the matter of the loan he was acting in his own interest and adversely to the interest of the bank.

Manhattan Savings Institution v. New York National Exchange Bank, 170 N. Y. 58, 62 N. E. 1079, 88 Am. St. Rep. 640 (1902)

Municipal coupon bonds, issued under the seal of the municipality and registered in the city clerk's office in a book kept for that purpose as prescribed by statute under which they were issued, but which statute did not require that they should be issued as registered, in contradistinction to coupon bonds, and be non-negotiable in character, are, when delivered to a purchaser thereof, negotiable, although a space for the name of the payee is left blank and it appears upon their face that they are so registered; and, unless their negotiability is thereafter restricted by the insertion of the name of some particular payee, although stolen, they are payable to any subsequent holder in good faith as the bearer.

When such bonds are stolen from the owner, a bank, which in good faith and before maturity advances money upon them, is entitled to assert a special property therein to the extent that they stand as security for the moneys loaned, in the absence of any circumstances imposing upon it some duty of inquiry.

The facts that the pledgor, who for several months had had an account with the bank as trustee, obtained the loan *as trustee;* that the corners of the bonds, which had been outstanding for twenty years, appeared to have been burned and that he was an ex-convict and a notorious character, of which fact, however, the

bank had no knowledge, cannot be considered as circumstances imposing any duty of inquiry upon it, since coupling the word "trustee" with his name as a depositor did not necessarily import that he was acting as trustee for others and require an investigation as to his authority, and the bonds might have been torn or mutilated by long use, and, having no knowledge of his character, the bank was not required to look upon him with any suspicion.

Wolff v. Lockwood, 70 App. Div. 569, 75 N. Y. S. 605 (1902)

The contest was as to whether B had made an unauthorized liquidating sale. The court found that B had. There was no contest over the measure of damages. The court said that the damages would be measured by the difference between the sale price and the highest price which shares of a similar character brought in the market within a reasonable time thereafter.

Burhorn v. Lockwood, 71 App. Div. 301, 75 N. Y. S. 828 (1902)

There was an unauthorized sale by B. A was notified the same day. B contended that A had ratified, but this contention failed. As to the measure of damages the court said that A was entitled to have the stock valued at the highest market price at which like stock was sold in the open market within a reasonable time thereafter, and that, in the case at bar, the limit of that time was from May 18 to June 12.

"This is an exception to the ordinary rule that for the wrongful conversion of personal property the damage recoverable by the owner is its value at the time of the conversion. The reason for the exception lies in the fact that stock is of a fluctuating value. The stock market at times becomes panicky and the customer would be at the mercy of the broker were the latter at liberty without notice or calling upon the customer for additional margin to sell the stock at a time when the market is depressed. Such stocks are usually held and are in the hands of brokers for speculation, and the measure of damages is what it would cost the customer to replace the stock within a reasonable time. The customer is given a reasonable time to replace the stock, or rather to determine whether he wishes to or is able to replace it, for replacing it is not a condition precedent to his right to recover damages. (*Smith v.*

Savin, 141 N. Y. 315) The authorities hold that what is a reasonable time in such case on uncontroverted facts is a question of law for the court, but no case is cited and we find none which lays down any rule as to what constitutes a reasonable time or states the elements that enter into the determination of the question, and therefore these precedents are of little or no aid. In *Smith v. Savin* (*supra*) it was stated, but not necessarily decided, that from May fourteenth to June twenty-first would have been an unreasonable time. In *Colt v. Owens* (90 N. Y. 368) it was held that thirty days was a reasonable time. In *Randall v. Albany City National Bank* (1 N. Y. St. Repr. 592) it was held that a reasonable time elapsed before the expiration of six months, and that the question depends upon the circumstances of each particular case. In *Scott v. Rogers* (*supra*) the reasoning of the court would indicate that, inasmuch as the broker is the defaulting party, the customer should be given a liberal allowance of time in which to replace the stock.

" The respondent resided in the city of New York and was here at the time. No other facts or circumstances are shown which aid in the determination of the question. In the absence of evidence of special circumstances showing other elements of necessity for further time, we think it may be stated as a general rule that the customer is entitled to a reasonable opportunity to consult counsel, to employ other brokers and to watch the market for the purpose of determining whether it is advisable to purchase on a particular day or when the stock reaches a particular quotation, and to raise funds if he decide to repurchase. Doubtless the customer's financial ability would not enter into a determination of the question, but assuming that he had property or securities he should be given a reasonable time to convert them into money or to raise money on their security. Perhaps the most important of these elements is time to reflect and consider what is the tendency of the market and at what price it is advisable to purchase in view of all the facts and circumstances. If the customer repurchases the stock at a higher figure, which is his right, he is investing his own money and running the risk of recovering it from the broker. On this record it appears that within the twenty-nine days following the unauthorized sale and prior to the twelfth day of June the

market price of this stock had become fairly settled again, and that there was within that period ample time and opportunity for the respondent to repurchase if he desired to do so. We are of the opinion, therefore, that the reasonable time during which the plaintiff is entitled to the highest price at which the stock sold on the Exchange expired prior to the twelfth day of June, and inasmuch as the highest price at which the stock sold prior to the last-mentioned date and after the unauthorized sale was sixty-two and seven-eighths on the eighteenth of May that should have been adopted as the basis of recovery" (p. 303).

Cammann v. Huntington, 89 App. Div. 99, 85 N. Y. S. 434 (1903)

If a pledgee has not authority to purchase himself, he may not purchase through a dummy. Whether the person making the purchase was or was not a dummy is a question to be determined by the trier of the fact.

Rothschild v. Allen, 90 App. Div. 233, 86 N. Y. S. 42 (1904), affirmed without opinion 180 N. Y. 561, 73 N. E. 1132 (1905)

B pledged to C. At the trial B offered to show what the arrangement between B and C was, and the offer was rejected. This was error. B was entitled to show, if such *was* the arrangement between B and C, that A could at any time, upon paying the amount of A's debt to B, obtain the pledge from C. In such case B was not obliged to keep in his possession or under his control a like amount of like stock.

The court proceeded on the assumption that the arrangement between B and C was such that A had this right against C. B failed, and C sold without communicating with A. Thereafter A demanded the pledge from B. Of course B failed to comply and this act was characterized by the court as a *conversion.*

With respect to C, there was a dictum. It said that the relation between A and B was that of pledgor and pledgee, that B had the right to pledge to C and obtain advances of money thereon, and that C obtained a good pledge which he could enforce by a sale without notice to A and without incurring any liability to him therefor.

Comment:

The court proceeded on the assumption that the arrangement between B and C was such that A could at any time upon paying the amount of A's debt to B obtain the pledge from C. We do not question that B had the right to make such a pledge. This goes back to the doctrine first announced by Mr. Justice Jackson in *Jarvis v. Rogers* (p. 193) and confirmed by Mr. Justice Story (p. 196).

But in such case C has merely derivative rights. He has not independent rights. He is the assignee of B, standing in B's shoes. Then surely he ought not to be allowed to sell without communicating with A and giving him an opportunity to pay the A, B (*not* the A, C) debt.

But A was suing, not C, but B. The court assumes that such an arrangement was made between B and C that A's rights were protected. Then that act was not a conversion. Nor was it a breach of contract. It was no kind of a wrong. It was a lawful act.

But B was under an obligation to return upon demand and tender. It is not stated that A tendered the amount of the debt. We do not see how A could have any cause of action until both demand and tender were made, unless the circumstances were such that a tender would be obviously futile (which would be a question of fact). And, if a tender may be dispensed with on the ground that it would be futile, then it would also be true that a demand could be dispensed with if a refusal is a foregone conclusion.

But even if A is treated *as though* he were in as good a position as though he had made tender and demand, B's failure to produce the stock is a breach of contract, not a conversion. There was no tortious withholding, because in the nature of things a person who does not hold cannot withhold (see our pp. 118–122).

Tompkins v. Morton Trust Co., 91 App. Div. 274, 86 N. Y. S. 520 (1904), affirmed without opinion 181 N. Y. 578, 74 N. E. 1126 (1905)

A (A stands in this case for numerous customers) bought stock on margin through B. X deposited with B for safekeeping a cer-

tificate for 50 shares of Standard Oil stock, this certificate being indorsed in blank. B tortiously pledged the stocks of A, and also the Standard Oil stock, to C, to secure a loan made by C to B. B failed. X notified C of his rights. C made a lawful liquidating sale of all the collateral except the Standard Oil stock, and the proceeds were enough to pay the B, C loan and to leave a slight surplus. A contended that the Standard Oil stock should be sold and that the proceeds (together with the slight surplus) should be distributed between A and X, according to the value of their securities which B had pledged to C. X contended that he alone was entitled to the Standard Oil stock.

The court decided for X. It said that C was protected on a principle of estoppel, quoting from *McNeil v. Tenth National Bank* (our p. 263), but that there was no such estoppel in favor of A. It further said that, on the one hand, B had large rights over A's stock, that a repledge to C under some circumstances would have been valid; but, on the other hand, B had no rights over the Standard Oil stock and the pledge of it by B to C was larceny.

Comment:

It had been previously held in *Smith v. Savin* (our p. 288) that if B pledges to C securities belonging to A and also securities belonging to B, C should have recourse first to B's securities. This case goes further and holds that C properly looked to securities in which B had a pledge interest before resorting to securities in which B had no such interest. The victim of a crime is not in equity to be called upon to stand no better than the victim of a conversion.

Judge Ingraham thought of B's tortious pledge of A's stock as a conversion (and not merely a "technical" conversion). It is true that he said that a broker has a right to pledge, so that a pledge is not a conversion, but he immediately quotes from *Douglas v. Carpenter* (our p. 220), so that it is apparent that his thought was that B might pledge on the conditions laid down in *Douglas v. Carpenter.*

(We not only concede, but urge, that a pledge by B to C is law-

ful (1) if B pledges A's securities, not mingled with other securities, to C to secure a debt not larger than A's debt to B, — that is to say, if B simply makes C an assignee of B's right, and does not attempt to give C more than he, B, has; or (2) if B does give C independent rights but retains in his possession or under his control securities of like kind and amount; or (3) if B does give C independent rights and does not make such retention *provided* that A gave a conscious, intelligent consent to such second pledge.)

Judge Ingraham quoted Chief Justice Church in *Gruman v. Smith* (our p. 280), and said that the relation between A and B was that of pledgor and pledgee, and that for a conversion of the pledge the pledgee was liable for the damages sustained by the pledgor. He later spoke of Meeker, a defendant who had borrowed from B $28,000, depositing securities worth over $40,000 which B had pledged to C, and said that this was " undoubtedly " a conversion, and that Meeker was entitled ". . . either to treat the pledge as a conversion and sue [B] for the damages sustained thereby, or to tender the amount due by her to [B] and take proceedings to obtain possession of the stock," (p. 283) and in another place, he said: " It is true the respondents could have treated this unauthorized use of their stocks as a conversion, and sued [B] for the amount due " (p. 284).

Was B's pledge to C of A's securities for an amount larger than A's debt to B a conversion? The court in both *Douglas v. Carpenter* and in this case answered that question with an unequivocal " Yes." It was not mentioned in *Wood v. Fisk*. See p. 230.

Brown v. Bronson, 93 App. Div. 312, 87 N. Y. S. 872 (1904)

Where the maker of a note, payable in four months after its date, as collateral security for the payment thereof, delivers to the payee a certificate of stock and allows such certificate to remain in the possession of the payee for more than ten years after the payment of the note without making any demand for the return of such certificate, an action subsequently brought by the maker to recover possession of the certificate is barred by the Statute of Limitations.

Minneapolis Trust Co. v. Mather, 181 N. Y. 205, 73 N. E. 987 (1905)

Where a trust company to which certain promissory notes of a third party and mortgages given as collateral thereto had been pledged and which had been instructed by the pledgor to foreclose the mortgages and " bid in the property for somewhere near its present value and take judgment against the makers of the notes for any deficiency there may be," instead of following instructions, bids in the property at the full face value of the securities with interest and costs thereon, which was much more than the value of the land, thus releasing the makers from any liability for deficiency, it is liable, not as for a conversion of the securities, but only for the difference between the value of the land and the amount bid for the same.

Hurd v. Taylor, 181 N. Y. 231, 73 N. E. 977 (1905)

A broker cannot recover from a customer moneys alleged to have been lost in stock transactions in the absence of proof of actual sales or purchases of stock for his account; and the fact that he offers no such proof and admits that the intention was that when such transactions were closed the amount lost or won was to be decided by the fluctuations of the market, renders them mere wager contracts upon which a recovery cannot be sustained.

Fairbairn v. Rausch, 104 App. Div. 259, 93 N. Y. S. 666 (1905)

An order given to a stockbroker by a customer to sell the latter's stock at the market means that the sale shall be made at the best price obtainable at the time the order is executed and not at the price quoted at the time the order is given.

Helm v. Ennis, 109 App. Div. 42, 95 N. Y. S. 1040 (1905)

A ordered B to purchase stock on margin. B did so. B later purchased like stock at a lower figure. A wished to take up his stock. B delivered certificates purchased at the lower price. A was not entitled to recover from B the profit which B had made; he was not entitled to the delivery of the certificates purchased by B for A's account.

Comment:

This was not a case where B had failed to make an actual purchase on the order of A. B had at all times like stock ready to deliver upon A's paying the balance of his debt. This was enough.

Content v. Banner, 184 N. Y. 121, 76 N. E. 913 (1906)

A ordered B to purchase stock for his account but furnished no margin. B bought the stock. Although B had supplied the whole purchase price, the relation of A and B was that of pledgor and pledgee, and a sale by B " on the curb " without notice to A of the time and place of sale was a conversion.

Hall v. Wagner, 111 App. Div. 70, 97 N. Y. S. 570 (1906)

A bought stock through B which was taken in B's name to enable B to collect dividends. A borrowed from B on the security of this stock. A telephoned B that she wished to pay the loan and take up the stock and would send a messenger to take it up. A gave to X a check for the amount due. X presented this to B, who delivered to X the certificate with a power of attorney to transfer, so that the stock could be transferred to the person presenting the certificate. X took the certificate and power to Y, to be credited to his account. Y subsequently sold the stock and accounted to X for the proceeds. Held, two judges dissenting, that the principle of *McNeil v. Tenth National Bank* did not apply, and that A could hold Y for a conversion of the stock.

Haight v. Haight & Freese Co., 112 App. Div. 475, 98 N. Y. S. 471 (1906), affirmed without opinion 190 N. Y. 540, 83 N. E. 1126 (1907)

When one advances money to stockbrokers to invest in securities, the relation is fiduciary and equity will take jurisdiction of an action brought against the brokers for an accounting.

When in such action it is shown that the brokers never purchased or sold the stock as ordered, but merely offset an order to purchase by one customer against an order to sell the same stock by another customer, etc., the transactions are fictitious, and an account rendered by such brokers, purporting to show pur-

chases and sales, is fraudulent and not binding on the customer although he had previously accepted it as true.

Under such circumstances the customer is entitled to recover the money advanced to the brokers, less any sums drawn by him, and the brokers are not entitled to make any charges back against the customer.

Assuming as valid a stipulation printed on the backs of the brokers' order blanks, providing that the order may be executed in any city or place, either on any exchange or by private sale as the broker may elect, and that any other customer of the broker may be purchaser or seller, but that the broker is not obliged to disclose the name of any customer, nevertheless actual transactions are intended by such stipulation and it is necessary for the broker to show real sales and purchases. It does not authorize the offsetting of purchases and sales by customers as mere bookkeeping entries, and the customer is not bound by such transactions.

Byrne v. Weidenfeld, 113 App. Div. 451, 99 N. Y. S. 412 (1906)

A purchased stocks through B, a stockbroker. A tendered payment of A's debt to B and demanded the securities. B replied that they had been pledged, and that he was unable to deliver them. A sued B for a conversion.

B offered in defense to show that A and B were joint adventurers in schemes requiring the borrowing of large sums on pledge, and that A's securities were out on such pledge. This offer was rejected. Error. New trial granted.

Comment:

B might have been able to show that the pledge was within his authority as a joint adventurer with B, and if so, of course he had not converted. He should have been given an opportunity to show this. This was all that was necessary for a decision.

But the court made two dicta which should be stated:

1. "The complaint of conversion is, so to speak, based not upon *cepit* but *detinet,* and the plaintiff was bound to show an existing right to the immediate actual possession of the securities at the time of the alleged conversion" (p. 452). But surely this is

wrong. For, if B makes a tortious sale or pledge, that does not (under the modern law of pledge) annihilate the pledge interest and give A the right to immediate possession, and yet the Court of Appeals had held again and again that A was entitled to sue B for conversion of the pledgor's interest.

2. After pointing out that the pledge by B to C might have been within B's authority as a joint adventurer with A (all that was necessary to a decision) the court said that if B had made the pledge to C for B's own benefit, the tender and demand would have " . . . sufficed to charge the conversion upon [B], for if then the securities were out of their possession, under such circumstances they were bound at once to regain them " (p. 453). This is inconsistent with what it has already said since C would be entitled to the possession of the pledge until C was paid. Moreover, a failure to deliver what one has no ability to deliver is *not* a conversion (pp. 118–123). B converted when he made the pledge to C (assuming that to have been tortious). If B failed later to deliver when A made tender and demand that was a breach of contract but it was *not* a conversion.

Sanger v. Price, 114 App. Div. 78, 99 N. Y. S. 513 (1906)

A was a cotton merchant in Waco, Texas, and B a cotton, stock and produce broker in New York City. B solicited A's business, and an arrangement was made under which if B desired further margin, B would telegraph A and A would deposit money in the Waco State Bank to the credit of B. At 10:30 (New York time) on a Saturday morning B telegraphed for more margin, but the telegram was not signed (A and B had agreed upon a telegraphic code). A received this at 10:30 (Waco time). The court said that A was entitled to a reasonable time to ascertain whether or not this telegram came from B. At about 11:55 (Waco time) A received a second telegram, signed by B (according to code). At 12:29 A telegraphed B that he was making the required deposit, and at 12:35 did make it. The court said that this was compliance within a reasonable time. The New York Cotton Exchange closed at noon on Saturday and before the closing B sold A out. A's margin was not completely exhausted. This the court

held to be an unauthorized sale *unless* B had a right to sell A out without notice.

Now, the course of business between A and B had been that when B executed an order, he telegraphed and then sent a confirmation by mail. The confirmation notices were upon printed blanks. On these after the signature of B there was in small type: " It is further understood that on all marginal business the right is reserved to close transactions when margins are running out, without further notice and to settle contracts in accordance with the rules and customs of the Exchange where the order is executed."

The court laid emphasis upon the word " further," and said that this contemplated that A should have " some " notice, and that this necessarily implied that he was entitled to a reasonable time to comply.

A had replaced his cotton futures and was allowed to recover the cost, less the proceeds of the sale.

Comment:

The word " further " should not have been used by B's counsel on the confirmation notices. Nevertheless it is open to question whether " further " notice did not mean notice further to that given by the small-type warning.

The court therefore did not reach the question whether an agreement by A could be constructed out of such small-type statement.

Note that this was a case of actual replacement. The measure of damages was therefore clear.

Treadwell v. Clark, 190 N. Y. 51, 82 N. E. 505 (1907)

A became indebted to B, a grocer, for provisions and pledged a certificate of stock for his indebtedness and any further indebtedness he might incur. A wrote his name on the back, but ". . . did not execute, or subscribe, any written assignment thereof, or any power of attorney in blank, or otherwise, authorizing any other person to assign said certificate " (p. 55). Later X tortiously took the certificate, and eventually it was sold to C. When C purchased he observed that there had been no regular, or formal,

transfer or assignment. Held, that a finding that he was not a bona fide purchaser was sustainable.

Burnham v. Lawson, 118 App. Div. 389, 103 N. Y. S. 482 (1907)

Where B has converted by an unauthorized sale, in measuring the damages the stock should be valued at the highest price in a period beginning not with the sale but with notice thereof to A. The court relied upon *Wright v. Bank of the Metropolis* (our pp. 284–286).

Comment:

See our discussion at pp. 269–273. We submit that as this was an action for conversion A should have been entitled to have the stock valued at the highest price in a period beginning with the sale, and ending with the expiration of a reasonable time after notice.

Strickland v. Magoun, 119 App. Div. 113, 104 N. Y. S. 425 (1907), affirmed without opinion 190 N. Y. 545, 83 N. E. 1132 (1907)

B took securities purchased for the account of A and a large amount of other securities and pledged to C, a bona fide pledgee, for an amount exceeding the debt of A to B (not having like securities in his control).

The court said that it is " unquestioned " that A might hold B liable for a conversion. " An unauthorized sale or loan is a conversion thereof " (p. 116).

Comment:

It is true that the principal contest was as to whether a person claiming under C had not had knowledge, when he took over from C, that the securities had been improperly pledged. But whether A could hold B for a conversion was one of the questions in the case, and the court had no doubt about it. Note that the court said that an unauthorized sale *or* loan is a *conversion.*

Not a word about this in *Wood v. Fisk.* See p. 230.

Violett v. Horbach, 119 App. Div. 373, 104 N. Y. S. 249 (1907)

A pledgor must disavow an unauthorized sale within a reason-

able time after notice, or he will be deemed to have acquiesced in it. Disavowal a year after notice was too late.

Bosoian v. Hubbard, 121 App. Div. 510, 106 N. Y. S. 178 (1907)

B, a cotton broker, had sold A out without notice. On memoranda of purchase handed by B to A of each purchase there was printed: "It is further understood that on all marginal business, the right is reserved to close transactions when margins are running out, without further notice, and to settle contracts in accordance with rules and customs of Exchange where order is executed."

A was an Armenian, uneducated, and read with difficulty. According to his story (1) when he opened the account he was assured his account would not be closed out without calling on him for more margin, and (2) he had never read the printed matter on any memorandum slip. The court said that a directed verdict for B was error, that if there had been such original contract between A and B it could not be modified in this manner, that a party to a contract may not modify it ". . . by giving repeated notices of his 'modification' to the other party, [even if] the latter silently receives them . . ." (p. 512).

MacDonnell v. Buffalo Loan, Trust, and Safe Deposit Co., 193 N. Y. 92, 85 N. E. 801 (1908)

A, a corporation (Medina Gas Light Company), was what is popularly known as a "one-man company." There were 300 shares. 298 were owned by X, one by Y, and one by Z. In all probability, X had put these two shares in the names of Y and Z simply that they might qualify as directors, and X was therefore the owner in equity (but such fact was not found below). A had no creditors. A executed a mortgage to B, as trustee, to secure $10,000 par value of bonds, and the majority assume (but such fact was not found below) that the bonds themselves were deposited with B for safekeeping until they were negotiated. X, who was secretary of A, ". . . pledged these bonds to [B] as security for personal loans which it had made and was to make to him. This was done without the knowledge or consent of [A]

and with full knowledge on the part of [B] that the bonds were authorized only for corporate purposes and were to be negotiated only by the president of [A] while they were in fact being used and negotiated by [X], its secretary, for his personal ends" (p. 94).

Later, A was in financial difficulty, and the plaintiff had, or claimed that he had, succeeded to A's rights and this suit was brought against B for a conversion of the ten bonds which were probably worth par, or nearly par, when issued but which later became of little value. B had become pledgee in 1886. In 1890 B transferred the bonds to the German-American Bank, in consideration of the payment by that bank to it of X's indebtedness. The plaintiff's predecessor in interest demanded the bonds from B in 1895. This action was begun shortly thereafter at a date less than six years from the time in 1890 when B had transferred to the German-American Bank.

All the judges agreed that B had converted the bonds. Three thought that the conversion occurred in 1886, and that therefore the Statute of Limitations was a defense. Four thought that the conversion occurred in 1890, and therefore that the Statute was not a defense. Counsel for B had urged, *totis viribis*, that there was no conversion until the demand-and-failure-to-produce in 1895.

Judge Werner, speaking for the majority, said of the argument that there was no conversion until the demand in 1895: "We think the plaintiff's contention is not tenable. The rule that one who comes lawfully into possession of property cannot be charged with conversion thereof until after a demand and refusal is too well-established to justify extended discussion (authorities). But it has no application in a case where the lawful custodian of property commits an overt and positive act of conversion by an unlawful sale *or disposition* of the same (authority). So long as [B] was in possession of the bonds, under circumstances which might have made that possession lawful or unlawful at its will, a demand and refusal were necessary to put it in the wrong, but when it assumed *to transfer* the bonds to the German-American Bank it committed an act which was in hostility to the right and title of

the plaintiff. *This* was a distinct and *unequivocal* conversion" (p. 101; italics supplied).

Why was B's act in taking the bonds of A as a pledge to secure X's personal indebtedness not a conversion? Judge Werner said: "The defendant acquired lawful possession of the bonds in 1886 and retained such possession until it transferred them to the German-American Bank in December, 1890. The character of this possession was not affected by the wrongdoing of [X] in pledging the bonds to secure his personal indebtedness to the defendant, nor by the apparent participation of the latter in this unauthorized act, for it could still have elected to continue in custody thereof as trustee. Having once lawfully acquired the physical custody of the bonds, the defendant could not be guilty of a conversion of them until it did something to indicate that it proposed to ignore the owner's rights and assert its own claim in hostility thereto. Nothing of that kind transpired until December, 1890, when the defendant assumed to treat the bonds as its own by transferring them to the German-American Bank in consideration of the payment by the latter of [X's] indebtedness to the defendant. That was the time when the defendant first evinced its purpose to ignore its trust and repudiate its lawful custody of the bonds by claiming dominion over them in hostility to the rightful ownership of the plaintiff's predecessor in title" (p. 102).

Judge Haight spoke for the three dissenting judges. He examined the facts and concluded that at the time the bonds were issued B, as trustee, had no powers or duties respecting the bonds except to certify that they were secured by the mortgage. "There is no pretense or claim that the bonds had been placed in the custody of the trustees for safekeeping, or that it became a bailee. Consequently the relation of bailor and bailee is not involved and need not be now considered. What is claimed and found as a fact is that at the time the bonds were brought to the defendant to be certified for identification they were then delivered to the defendant by [X] as collateral security for the payment of certain notes of his, upon which he had made previous loans and upon which he had that day borrowed an additional sum of $6,000. [B] thereupon took the bonds into its custody, not as trustee, but as pledgee,

holding them as collateral security for the payment of the loans made [to X]" (p. 114).

The plaintiff alleged that X diverted the bonds from the purpose for which they were executed, and that B had, with full knowledge of the facts, participated in the diversion. Judge Haight thought that the taking of the bonds by B on such facts was a conversion. "It further follows that [B] having taken these bonds as pledgee of [X] as security for loans made, with full knowledge of all the facts, to which attention has been called, and that these bonds had been wrongfully diverted by [X], itself became chargeable as for conversion and thereby became liable to respond in damages to [A]. It further appearing, as we have seen that [B] from that time on held these bonds as collateral security for its protection and not as trustee for [A], and it also appearing that it having no jurisdiction or right to control the disposition or the custody of the bonds as trustee, and that its possession was wrongful, no demand was necessary to be made by [A] before the cause of action accrued; but the Statute of Limitations commenced running from the time that [B] wrongfully diverted these bonds by taking them from [X] for its own use and purpose" (p. 116).

Comment:

1. The counsel for A was Louis Marshall, Esquire, in his day one of the leaders of the New York bar. In his brief he said that the plaintiff's cause of action accrued upon the demand of the bonds from the latter by the plaintiff therefor, and the refusal to return the same on August 26, 1895. There were therefore three dates to consider. Did the conversion occur in 1886 when X pledged to B, or in 1890 when B transferred to the German-American Bank, or in 1895 when there was a demand, and a failure to produce. Counsel for A urged that 1895 was the date.

The seven judges were *unanimously* against him on that. Four thought the conversion occurred in 1890 by the tortious transfer; no subsequent demand was necessary. (By Judge Werner, p. 101.) Three thought the conversion occurred in 1886; no subsequent demand was necessary. (By Judge Haight, p. 116.)

Demand and refusal are sometimes pertinent in conversion.

But when? And the answer is as plain as day. *Only* in cases of tortious *withholdings* (the second species of conversion; see our pp. 118–123). If there is a tortious taking, or a tortious transfer, or a tortious alteration of the condition of the property, or a tortious user, or a denial of the plaintiff's title (species 1, 3, 4, 5, and 6; see our p. 118) demand is immaterial. It is not necessary to complete A's cause of action for a conversion, and if made and there is a failure to produce it does not give A a new cause of action. It is just immaterial. It neither subtracts nor adds, nor multiplies nor divides. It is zero.

True it is, that the cases in which there has been a conversion by reason of a tortious withholding (species 2) probably outnumber all the cases of conversion in species 1, 3, 4, 5, and 6, put together, by something like two to one. It therefore follows that in the bulk of conversion cases demand and refusal will be pertinent. One can therefore understand how a judge who reads something about demand and refusal in two out of every three cases he reads might derive the impression that in conversion cases demand and refusal are *always* pertinent. But no *strong* judge will do this.

No one could ask for a more definite and lucid statement about demand and refusal than was contained in the opinions in this case. We repeat that while the judges split, 4 to 3, as to whether the conversion occurred in 1886 or 1890, they were *unanimous* that the demand in 1895 had nothing to do with the case.

This case *ought* to have settled the New York law as to the place of demand and refusal in conversion cases. And it was only seven years before *Wood v. Fisk.*

2. As to whether the conversion occurred in 1886 or 1890, we agree with the three dissenting judges. It was once thought that if A bailed to B, and B pledged to C for his own debt, C was a converter forthwith, even if he were a bona fide pledgee. This was Lord Ellenborough's thought, expressed in his opinion after the first trial in *M'Combie v. Davies,* 6 East 538 (1805). But the English law was settled to the contrary by *Spackman v. Foster,* L. R. 11 Q. B. D. 99, 52 L. J. Q. B. 418, 48 L. T. R. 670, 47 J. P.

455, 31 W. R. 548 (1883), and the principle of *Spackman v. Foster* is pretty surely law in America. See *Varney v. Curtis,* 213 Mass. 309, 313; 100 N. E. 650, 653, L. R. A. 1916A629, Ann. Cas. 1914A340 (1913), and *Deering v. Austin,* 34 Vt. 330 (1861). That is to say, if there is to be a conversion of the species 6a variety (p. 118), a claim by a possessor of *less* than the fee, *if made in good faith,* is not a conversion. It is not a major tort.

But if the claim is made in bad faith, as it was in the case at bar, we believe that it ought to be denounced as a conversion. Clearly X was a converter, and clearly B participated in that conversion with full knowledge of the facts, and, moreover, derived an advantage to itself by so participating.

3. The fact that A was a " one-man company " explains why B did what would otherwise be an amazing thing to do. But X cannot be permitted in one breath to say that A is a distinct legal unit from himself and in the next breath to say that " in substance " A is only an alias for X. (See Corporate Advantages without Incorporation.)

4. The minority thought that B did *not* acquire possession as bailee from A. Therefore the interesting question presented by *Wilkinson v. Verity* (p. 203) could not arise. The majority did think B acquired possession as bailee, and therefore if the action had not been begun until more than six years after the transfer to the German-American Bank, the *Wilkinson v. Verity* question would have been presented. But the action was begun so as just to get under the six-years wire.

Clappe v. Taylor, 125 App. Div. 605, 109 N. Y. S. 1072 (1908)

The relation between a stockbroker and his customer on a purchase of stocks on margin is that of pledgee and pledgor, and a sale by the broker of the stock without demand and notice is a conversion for which he is liable in damages.

Matter of Mills, 125 App. Div. 730, 110 N. Y. S. 314 (1908), affirmed without opinion 193 N. Y. 626, 86 N. E. 1128 (1908)

A " see also " to *Tompkins v. Morton Trust Co.* (our p. 301).

Mullen v. Quinlan & Co., 195 N. Y. 109, 87 N. E. 1078, 24 L. R. A. (N.S.) 511 (1909)

The court said: "It is, also, contended on behalf of the defendant that the failure of the plaintiff and of his assignors to make a tender of the balance of the purchase price of the stocks was fatal to a recovery. This action was in trover, for the conversion of the securities purchased for the plaintiff and for his assignors, and, *there having been an actual conversion, a demand upon the defendant was unnecessary to render it liable.* This rule is well settled (authorities). The property in the stocks purchased by the defendant was in the plaintiff and his assignors, and the relations between the parties were those of pledgors and pledgee (authorities). The sale, therefore, without notice to, or consent of, the plaintiff and his assignors constituted a conversion. There was no agreement permitting it and there was no default on their part justifying the act (p. 115; italics supplied).

Jones v. Seaman, 133 App. Div. 127, 117 N. Y. S. 288 (1909), affirmed without opinion 200 N. Y. 553, 93 N. E. 1123 (1909)

For B, a pledgee, to have stock in X, pledged to him, transferred on the books of X into the name of C, B's agent, is not a conversion.

McIntyre v. Whitney, 139 App. Div. 557, 124 N. Y. S. 234 (1910), affirmed without opinion 201 N. Y. 526, 94 N. E. 1096 (1911)

A bought stock for $45,125 and paid B $5,000. B converted by delivering the stock to another firm of brokers to fulfill an obligation of B to such firm, and was credited by them with $45,-818.20. Thereafter A paid B sums totalling $25,000 in reduction of his debt, not knowing that B had converted the stock. The only question was as to the measure of damages. The stocks fell and at any time might have been replaced at $45,125 or less.

Mr. Presiding Justice Ingraham thought the damages should be $45,818.20 less $40,000; and that A should bring a separate action to recover back the $25,000.

But Miller, Laughlin, Clarke and Scott, JJ., held that A might

recover back \$45,125 less \$15,000 (with proper adjustments for interest).

Comment:

1. On principle it is, we submit, entirely clear that A may at least have the stock valued according to the market price at the time of the conversion. To say that his damages decrease as the stock falls is carrying the breach-of-contract thought so far that it becomes a *reductio ad absurdum;* but note that if A brings assumpsit (and not indebitatus assumpsit for the proceeds) there is no logical escape from saying that A has no cause of action in contract until he " is minded to sell " and that, therefore, if he gave no indication of a desire to sell at the date of the conversion he cannot, for a breach of contract, recover even the price on that date.

From such price, with interest, should be deducted the debt. It is sensible, and under the New York procedure permissible, to have the amount of the debt determined as of the date of the trial. Was not Mr. Presiding Justice Ingraham unduly and unusually technical?

2. It is true that Mr. Justice Miller said: " So far as the rule of damages is concerned, it is wholly immaterial whether the action is in tort or contract " (p. 561). But he made that remark in considering what A's remedies were *forthwith* after B's wrongful act — he might sue for the conversion or he might sue in indebitatus assumpsit (old forms of action) for money had and received to A's use. With regard to *such* a case, it may well be that the result is the same whether A moves in tort or indebitatus assumpsit (although on the figures given in the report there was a slight difference). But that is a very different proposition from the proposition that *whenever* B's act is wrongful, the damages must be " just the same " whether A elects to sue in tort or assumpsit, — that assumpsit and trover are one remedy, and that assumpsit is that remedy. See our p. 243.

3. We regret to say that Mr. Justice Miller used the terms " technical conversion " and " actual conversion." Apparently *he* meant by a technical conversion one committed by an honest blunderer, *one* of Judge Cardozo's many meanings (our p. 233).

Keller v. Halsey, 202 N. Y. 588, 95 N. E. 634 (1911)

B claimed that when A opened his account there was an agreement that if margin was exhausted B might sell without notice. The trial judge directed a verdict for B. The court reviewed the evidence and held that the facts presented a question for the jury.

Moore v. Rodewald, 142 App. Div. 741, 127 N. Y. S. 725 (1911)

Where a wife allowed her husband to pledge securities owned by her as margin on his individual stock transactions, the brokers, knowing that the securities belonged to the wife, had, nevertheless, a valid pledge interest therein, which they could satisfy by a sale of the securities after notice to her.

And where the wife, suing the brokers for conversion in selling the securities after demand upon the husband for further margin, bases her action solely upon the proposition that the defendants never acquired a valid pledge interest and refuses to amend her complaint to conform to the proof and asks a recovery upon the ground that the brokers sold the securities without notice to her, her complaint should be dismissed.

Jenkins v. Conklin, 146 App. Div. 301, 130 N. Y. S. 778 (1911)

Where a stockbroker advances money to buy stocks for a customer, the stocks to be held by the broker as security for the loan, the relation of pledgee and pledgor exists.

In the absence of any special agreement that the security shall be first resorted to by the pledgee, the general rule is that he is neither required to realize upon it nor to return it before suing upon the debt.

But where a pledgee of stock holds certificates so indorsed that he can negotiate them and give a good title to a transferee free from claims of the pledgor, he must, when suing the pledgor for the debt to which the stock is collateral, produce the pledge at trial. On his failure to do so, his complaint should be dismissed, but not upon the merits.

Small v. Housman, 208 N. Y. 115, 101 N. E. 700 (1913)

Plaintiff, whose son was employed by defendants, a firm of stockbrokers, opened through him an account for buying and sell-

Samuel H. Gottscho, Jamaica, N. Y.

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ing stocks and bonds upon margin. For more than two years plaintiff's transactions, which were quite numerous, were consummated through the agency of her son. Plaintiff then went abroad but gave the defendants no notice and left no foreign address with them and no directions concerning her account. The son continued to buy and sell through the defendants and, when margins were needed or demanded, procured securities of plaintiff from her safe deposit box, which were given to defendants to protect her margin. A panic coming on, the defendants demanded more security and the son, being unable to obtain instructions from plaintiff, gave them all of her securities in his possession. Defendants thereupon asked the son to order the sale of the securities, which he refused to do and requested defendants not to sell them. Defendants, however, upon a few hours' notice to the son, sold part of the securities. The son then arranged with other brokers to carry part of plaintiff's account and was told in substance by one of the defendants that they would carry the balance of it until his mother's return. Defendants, however, thereafter on short notice to the son sold some of the securities. This action was brought to recover from defendants damages for their conversion.

Held, that the facts are sufficient to sustain the conclusion that plaintiff's son was her agent in the transactions with defendants and that notices of the proposed sale of plaintiff's securities given to her son were, in legal effect, notices to her. Held, further, that the question whether an arrangement was made by which the defendants were to carry the balance of the account until plaintiff's return, and whether, under these circumstances, the notices of sale given both before and after the alleged agreement were reasonable and sufficient was not a question of law for the court but one of fact for the jury.

Hickok v. Cowperthwait, 210 N. Y. 137, 103 N. E. 1111, Ann. Cas. 1915B 1002 (1913)

The general rule is that the pledgee of chattels loses his pledge interest by returning them to the pledgor. If the thing, however, is delivered back to the owner for a temporary purpose only, and

it is agreed to be redelivered by him, the pledgee may recover it against the owner, if he refuse to restore it to the pledgee, after the purpose is fulfilled.

Where a pledgee held stock as security and returned it to the pledgor for the special purpose of having it transferred to another on the books of the company, with the understanding that the substituted certificates should, when issued, be delivered to the pledgee, which was done, he having no knowledge of any fraudulent intent on the part of the pledgor, no other lien having attached in the interval, the pledgee did not lose his right *in rem* as against the creditors of the pledgor.

Kavanaugh v. McIntyre, 210 N. Y. 175, 104 N. E. 135 (1914)

A pledged securities to B, a firm of stockbrokers. Precisely what was the purpose of the pledge is not stated, but the trial court refused to find that the securities were deposited on margin. B sold the securities and deposited the proceeds in a bank to B's credit. B became bankrupt. Three of the members were thereafter discharged in bankruptcy. A sued them, and they pleaded their discharge.

Since the date of the facts in *Crawford v. Burke* Congress had, in 1903, amended the Bankruptcy Act so as to exclude from the protection of the discharge " liabilities . . . for willful and malicious injuries to the . . . property of another."

The court held that the sale came within the scope of these words. Apparently these defendants had themselves not participated in the wrong. Nevertheless, as partners, they were liable, and so not protected by the discharge. " If the defendants are civilly liable for the acts of other members of the firm, which amount to a willful and malicious injury to the property of the plaintiff, that ends the argument. They are not released by the discharge in bankruptcy, no matter whether they participated in the acts which caused the injury or not " (p. 183).

Smith v. Craig, 211 N. Y. 456, 105 N. E. 798 (1914)

A bought and sold cotton futures through B, cotton brokers. He was sent memoranda of purchase and sale on each of which

was printed: "On all marginal business the right is reserved to close transactions when margins *are running out* without further notice and to settle contracts in accordance with rules and customs of the New York Cotton Exchange" (in the report, pp. 462, 463, the words "are running out" are italicized and there is no statement that the italics were supplied). A testified that he did not read the memoranda except to look at the prices therein stated.

The court said: "If the parties to the transaction had entered into a formal agreement as to their marginal dealings in the language of the printed notice on the statements offered in evidence we are of the opinion that such agreement would be a complete defense to the plaintiff's alleged cause of action. Under such agreement the words 'further notice' include any and all notices other than the notice contained in the agreement itself. The agreement was intended to give to the defendants the right to close the transaction without notice and at any time when the margins paid by the plaintiff were in fact running out (p. 463).

"We are of opinion that the court should have received the statements in evidence in connection with the other facts and circumstances relating to the transactions between the parties in April, May and June, and that it should have been left to the jury to determine whether the plaintiff had agreed with the defendants that in case his margins were running out they could sell his contract without notice to him of the time and place of such sale.

"The statements, with the printed notices thereon, received by the plaintiff after each purchase and sale, did not conclusively establish a contract between the plaintiff and defendants in their marginal dealings in cotton, but they were evidence to be considered in connection with the testimony of the plaintiff — the history of the transactions between the parties before the summer vacation — and the facts connected with the particular transaction out of which the plaintiff's alleged cause of action arose, for the purpose of determining the intention of the parties in connection with such marginal dealings (*Keller v. Halsey,* 202 N. Y. 588, 597)" (p. 464).

Wood v. Fisk, 215 N. Y. 233, 109 N. E. 177 (1915).
See our pp. 225–256.

Thompson v. Baily, 220 N. Y. 471, 116 N. E. 387 (1917)

This was an action by A against B for conversion. The trial judge dismissed A's complaint, and this judgment was affirmed by the Appellate Division. The Court of Appeals unanimously reversed the judgment and ordered a new trial.

A was a Southerner who had speculated in cotton through B, members of the New York Cotton Exchange. The opinion of the court was written by Judge Cardozo and we give it in full.

"The defendants are cotton brokers and members of the New York Cotton Exchange. The plaintiff is their customer. He resides in Wilmington, North Carolina. His dealing with the defendants began on December 14, 1909. On that day he gave an order to one Carmichael, the defendants' agent in Wilmington. The order was for the sale of 100 bales of October cotton. At the same time he gave Carmichael $400 for margin. He made inquiry concerning the terms on which the defendants did business. He was told that when they required additional margin, they called on their customer for it. The next day the plaintiff received in Wilmington a letter from the defendants in New York. They acknowledged receipt of the order and the margin, and stated that they inclosed confirmation of the sale. The notice of confirmation is a printed form. It states the execution of the order, and ends as follows: 'It is further understood that on all marginal business, the right is reserved to close transactions at our discretion without further notice when margins are running out. Very respectfully, Baily & Montgomery.' The plaintiff does not deny that he read this notice. Writing to the defendants a few days later, he said, 'Your favor of the 14th inst. is at hand and noted.' On December 28, 1909, the defendants asked him for additional margin of $200, which he sent them. On January 10, 1910, the transaction was closed at his request. It was closed at a profit. The plaintiff then had $640 remaining in the defendants' hands.

"It is in connection with the next transaction that controversy

has arisen. On January 12, 1910, the plaintiff in Wilmington telegraphed to the defendants in New York to buy 100 bales of March cotton. He offered Carmichael $400 margin, for he supposed that the proceeds of the first sale had been sent to him. He was told, however, that the defendants still held the proceeds, and that no other payment was then necessary. The defendants on the same day wrote the plaintiff that the new order had been executed, and inclosed a notice of confirmation, reserving the right to close the transaction at their discretion without further notice when margins were running out. This notice reached the plaintiff on January 13. He does not deny that he read it. On the following day, January 14, there was a panic in the cotton market. The defendants at 2:35 P.M. telegraphed Carmichael: 'Get 300 Thompson, answer. Market in panic.' It was 2:58 P.M. before this telegram was received. Carmichael notified the plaintiff, who had an adjoining office. The plaintiff responded at once, and promised to send $300 that evening. Carmichael said that this would be satisfactory. At 3:12 P.M. he telegraphed the defendants: 'Thompson will send check by to-night's mail for $300.' In the meantime the plaintiff's cotton had already been sold. The price of cotton was going lower and lower; and while their telegram demanding margin was still on its way to Wilmington, the defendants closed the transaction. They telegraphed Carmichael at 2:56 P.M. that they had sold the cotton at 13:59 cents per pound. In fact, they had sold it at 13.50. The telegram reached Carmichael at 3:22 P.M., and at once he notified the plaintiff. On January 17 the plaintiff wrote to the defendants that the sale was unauthorized. On January 18 the defendants telegraphed Carmichael that March cotton was at 13.55, and told him 'to notify Thompson.' He did so, and suggested that the defendants would buy the cotton back if Thompson would send them some more margin. The suggestion was not accepted. On January 14 and January 22 the price of March cotton rose to 14.50, and a few days later it was still higher. The plaintiff again made protest to the defendants, and, failing to obtain redress, began this action. At the close of the evidence his complaint was dismissed.

"The defendants say that the plaintiff must be held as a matter of law to have agreed that his cotton might be sold without notice whenever margins were running out. We do not share that view. In the absence of an agreement to the contrary, a purchase upon margin charges a broker with the duty to carry the thing purchased for his customer until additional margin has been demanded and refused (*Markham v. Jaudon*, 41 N. Y. 235; *Richardson v. Shaw*, 209 U. S. 365). If some other agreement was made, the defendants have the burden of proving it. They claim to have proved it in two ways; first, by the notice which they gave to the plaintiff after they filled his order in December, and again by the notice which they gave him after they bought the cotton in controversy. Whether the effect of these notices was to make out a new contract was a question for the jury. The plaintiff's assent is not so clearly proved as to make a question for the court.

"The previous transaction, standing by itself, did not prove a course of dealing. It did not prove, as a matter of law, that later transactions would be subject to the terms stated in the notice of confirmation (*Smith v. Craig*, 211 N. Y. 456, 464). It left the terms equivocal, for the notice of the reservation of a right to sell at discretion may have been nullified in the plaintiff's mind by the statement of the defendants' agent that margin would be asked for if required. The perfunctory warnings of a printed blank express at the utmost the defendants' general practice. They will readily yield to other and more specific statements of the practice to be followed in dealings with a particular customer (*Clark v. Woodruff*, 83 N. Y. 518, 523). The lines of the contract are not so sharply defined that the court is free to trace them unaided by a jury. The defendants did not ask the plaintiff in so many words to assent to their reservation of extraordinary powers. They left his assent to be inferred from his receipt of printed forms, which belied the assurance already given by their agent. In such a situation we cannot say, even as to the first transaction, that the terms of the notice became as a matter of law a constituent of the contract. Still less can we say that they became a constituent of other and later dealings. That depends

upon the intention of the parties which must be gathered from all the circumstances (*Smith v. Craig, supra; Keller v. Halsey,* 202 N. Y. 588, 597).

"A jury could, therefore, find that the order of January 12 was given in the belief that the defendants would assume the usual duty of a broker to close the transaction upon notice. The defendants filled the order, accepted the plaintiff's margin, and held the cotton as his property. They could not shake off the duties implied by law except by some new agreement. To make out that agreement they refer us to the notice of January 12 which reached the plaintiff on January 13. But that notice until assented to by the plaintiff did not constitute a contract. At the utmost it was a proposal to enter into a contract. Viewed most favorably to the defendants, it was a statement to the plaintiff of the terms on which the defendants were willing to continue to carry his cotton. Its significance even for that purpose must be estimated in the light of the earlier transaction. But to say that the plaintiff understood it as a new offer is not to say that there was a new contract. He had a reasonable time within which to make up his mind whether he would accept the offer or reject it. If he rejected it, the defendants even then would not have been at liberty to close the transaction without reasonable demand that he take up the cotton, or without notice of the time and place of sale in the event of his default (*Richardson v. Shaw, supra; Skiff v. Stoddard,* 64 Conn. 198). Silence after a reasonable time had passed might be deemed the equivalent of assent, but assent in some form there must have been if the sale is to be upheld. In this case we cannot say as a matter of law that the plaintiff had unreasonably delayed in rejecting the defendants' terms. The confirmation notice with its attempted reservation of a right to sell at discretion reached him on January 13, and in less than a day thereafter the sale was made. We think the case was for the jury.

"There is nothing in the point that the plaintiff should have bought back the cotton on January 18, sent more margin to the defendants, and traded with them again. He was not bound to renew his dealings with delinquent brokers. By that time, more-

over, there had been an intermediate advance in prices, and *the right to recover damages had already accrued.* (Italics supplied.)

" The judgment should be reversed and a new trial granted, with costs to abide the event.

" Hiscock, Ch.J., Chase, Collin, Hogan, McLaughlin and Crane, JJ., concur.

" Judgment reversed, etc."

Comment:

1. We rejoice in seeing the court disinclined to give relief from common law duties by a statement of B's claims on a printed form which contains memoranda of purchases and sales. The customer's attention will be directed to the prices stated, and it is not decent to try to put something over on him through printed notices which the customer will probably not attentively read, and which the broker probably hopes he will not attentively read. The law should require an intelligent, conscious consent. The attention of the customer should be called to the risk he is taking, not diverted from it. The notice should not be a wrapper to a sandwich. The customer will be interested in the sandwich, not the wrapper.

2. Note the words which we italicized near the close of the opinion. " The right to recover damages had already accrued." A, a margin customer, sues B for a conversion made by an unauthorized sale. Is that a conversion? Yes. No talk about " technical conversion." How about damages? They are fixed by the facts existing at the time of the conversion. No talk about " wait and see."

Matter of Dickinson, 171 App. Div. 486, 157 N. Y. Supp. 248 (1916)

If A orders B to sell at a price, and B reports that he has so sold, although that is not according to the fact, A may charge B with the market price of the stock within a reasonable time after the discovery by him of the fraud, and is not limited to the order price.

Small v. Housman, 220 N. Y. 504, 116 N. E. 359 (1917)

The defendants, as copartners, were engaged in business as stockbrokers in the city of New York, and plaintiff was their cus-

tomer. In 1905 her son became an employee of the defendants, and immediately thereafter the plaintiff, represented by her son, opened an account with the defendants for the purchase and sale of stocks and bonds. During the absence of the plaintiff in Europe on October 24 and 25, 1907, defendants sold stocks and bonds of plaintiff in default of margin; thereafter she commenced this action to recover damages for a conversion. Upon the trial the jury found a verdict for plaintiff.

The judgment entered thereon was reversed by the Appellate Division and a new trial granted. Defendants in their answer had affirmatively alleged that " these defendants in accordance with the customs and regulations of the New York Stock Exchange, after giving to the plaintiff due and reasonable notice of the time and place of sale duly sold at the New York Exchange for the best price that could be obtained," the securities in question. Evidence having been adduced from one of the defendants upon direct examination as to the regularity of the sales made, counsel for plaintiff was entitled to cross-examine the witness as to the manner, time, and place of the sale, the party to whom the sale was made, whether or not it was made to the defendants or to a member of either of the defendants' families, or any near relative of defendants, and the price obtained on the sales as bearing upon the question of reasonableness of notice, the regularity and validity of the sale to which the witness had given evidence on his direct examination, likewise as affecting the credibility of the witness.

After examination of the evidence relating thereto, the upper court held that the trial court properly charged the jury with reference to the notice of the sale of the securities given to plaintiff's son: " In considering what would be a proper or reasonable notice you have a right to consider the condition of the market on those days [the days when the sales were made]; you have a right to consider the relationship that existed between these defendants and the plaintiff, the length of time that such account was carried by the defendants for the plaintiff. And if you believe that the defendants had knowledge of the financial condition of the plaintiff, you have a right to consider that in connection with

the question whether the notice given on the 24th and 25th [of October] was reasonable and a fair one."

Mayer v. Monzo, 221 N. Y. 442, 117 N. E. 948 (1917)

B brought suit against A, a margin customer, to recover a balance due. A made a counterclaim for a conversion by B. B had pledged the shares of stock bought on A's account together with those of other customers with C, a bank, to secure loans made by C to B, and it did not appear (1) that A's shares had in any manner been segregated from those of others, or (2) that any arrangement had been made between B and C by which A should receive notice of the time and place of any sale which C might be authorized to make, or (3) that securities alike in kind and amount had been retained by B for delivery to A on payment of A's debt to B.

During the 1907 panic, B suspended on the New York Stock Exchange, and made an assignment for the benefit of creditors, and was subsequently adjudicated bankrupt. C sold the securities pledged to it by B (which included the securities of A) without giving notice to A. Subsequently B settled with creditors and resumed business.

B suspended on October 22, 1907. The pledge by B to C was prior to that date; the precise date does not appear from the report. C liquidated its collateral between October 22, 1907 and December 1, 1907.

The court said that the sale of the stock under the circumstances amounted to a conversion; that the general rule is well settled that a broker intending to sell the stocks of a customer carried on margin must give reasonable notice of the time and place of such sale if he would avoid the charge of conversion, and that " the further rule must follow that if a broker for his own indebtedness has rehypothecated his customer's stocks with another, he will not, under such circumstances as appear in this case, be relieved of the obligation to give notice to the customer of the proposed sale of the latter's stocks by the new pledgee, and if this notice is not given the broker [himself] will be chargeable with conversion " (p. 445).

But, assuming there was a conversion by B at the time C sold, B's counsel urged that the trial court was justified in dismissing the counterclaim as a matter of law, because A suffered no damage. Apparently (it is not specifically stated in the report) the shares continued to fall for some little time. Then they rose. A claimed that he did not receive notice of the sale for more than a year after it occurred, and he sought to have the stocks valued at the highest price which prevailed between the sale and the notice to him thereof.

The court said: " The rule is that a person whose stocks have been converted is entitled to a reasonable time after notice of the conversion within which to determine whether he will purchase other stocks in the place thereof and that he may use as a basis for his claim of damages resulting from the conversion the highest prices which have prevailed during such reasonable period. (*Baker v. Drake,* 53 N. Y. 211.) It has been held under varying circumstances that thirty days or fifteen days or sixty days would be such reasonable period. (*Colt v. Owens,* 90 N. Y. 368; *Wright v. Bank of the Metropolis,* 110 N. Y. 237; *Minor v. Beveridge,* 141 N. Y. 399; *Mullen v. Quinlan & Co.,* 195 N. Y. 109.)

" The defendant, relying upon this rule, says that he did not receive notice of the sale of his stocks for more than a year after it had occurred, and that by taking advantage of the highest prices which prevailed within that period for stocks of the kind carried for him by the plaintiffs he is entitled to an amount of damages which not only would wipe out plaintiffs' claim, but in addition would give him judgment for a substantial amount against them. *His conclusions are doubtless correct if it is to be assumed that he neither received nor was chargeable with notice or knowledge of the sale of his stocks until the time fixed by him.* We think, however, upon the evidence as it is now presented to us that a jury might find facts which would charge him with the knowledge of the sale of his stocks as of about the date when the same occurred " (p. 446; italics supplied).

The court therefore reversed the judgment and granted a new trial.

Comment:

1. All that A wanted was the highest value between sale and notice. Pretty surely this was higher than any price touched between B's pledge to C and C's sale. A did not ask that the pledge, without more, should be a conversion. And the court did not say that it was. It said that there was a conversion when the sale by C occurred. The courts incline (and we believe very wisely incline) *against* the notion that a defendant who has converted property at one date may be held liable at the plaintiff's option for a second conversion at a later date. We think therefore that, when the court held that there was a conversion by C's sale, that affords some basis for arguing that it may, subconsciously at least, have assumed that there was no prior conversion by the tortious pledge to C. But it certainly is not clear that this was the court's thought.

2. As to the measure of damages, the court said things which seem to us to be inconsistent. On p. 446 it says that a person whose stocks have been converted is entitled to a reasonable time "after notice" of the conversion. But it then said that A relied upon that rule, alleged he had had no notice for more than a year after the sale, and sought the highest value *between sale and notice,* and that his contention was "doubtless correct" if the fact was that he did not have notice until the time he claimed. In a word, the court, in succeeding paragraphs of its opinion, first says that the highest-intermediate-value period is from notice of sale to the expiration of a reasonable time thereafter, and then says that such period is the period between sale and the expiration of a reasonable time after notice of the sale has been received.

Gouert v. Mechanics & Metals National Bank, 176 App. Div. 507, 163 N. Y. S. 311 (1917)

A was a margin customer of B. He agreed in writing that securities purchased for his account might be pledged together with other securities for a sum greater than his debt to A. X deposited certain bonds with B for safekeeping. B pledged both A's securities and X's bonds to C. The court, referring to X, said: "In so doing [B] was undoubtedly guilty of a wrongful conversion" (p. 510).

C sold all the collateral except some shares belonging to A. All the collateral was worth more than B's debt to C. The question was: Who was entitled to the surplus?

The court said: "The position of the case, then, stands thus: B had in his hands securities belonging to X which he had no legal right to hypothecate. He had also in his hands bonds belonging to A which he had the legal right to hypothecate. He commingled the two classes of securities and hypothecated them all for his general indebtedness to the bank, C. Under these circumstances it is well settled that X has a right to demand that recourse be first had to A's securities for the payment of the second debt, and that X's securities shall be resorted to only after A's securities have been applied, and where, as in this case, X's securities have already been sold, X is entitled to a judgment that the remaining securities held by C be sold to satisfy the debt still due, and the balance, if any, remaining after the debt has been fully paid, be paid over to X up to the value of X's bonds, before any part thereof is paid to A" (p. 510; A, B, C and X have been substituted for the actual names).

Comment:

A tortious pledge by B to C of securities in which B has no interest is "undoubtedly" a conversion, and the damages would be for the full value of the property.

We submit that, similarly, if B, a pledgee, makes a tortious pledge B converts A's pledgor's interest. The only difference in the two cases is that in the first there is no debt to be deducted from the value of the securities, and that in the second case there is a debt to be deducted.

Leishing v. Van Buren, 183 App. Div. 296, 170 N. Y. S. 688 (1918)

A had a margin account with B and deposited two certificates each for five shares of the common stock of U. S. Steel. B sold them, but informed A and agreed to replace, which he did by purchasing one certificate for ten shares. He then pledged this certificate to C, with an indorsement thereon which purported to be the indorsement of A, but which A declared to be a forgery.

C's office was connected by wire with B's office, and C bought and sold stocks for B, and carried stocks bought, and the certificate for ten shares was delivered by B to C to secure his account. C later sold this certificate. A sued C for a conversion, and the trial judge directed a verdict against C on the ground that C had acted with constructive notice of A's rights and that therefore C was guilty of conversion in selling the stock without notice to A.

Mr. Justice Cochrane, speaking for the majority of the court, said that a directed verdict was wrong, — that the question whether B was agent of C should have been left to the jury. He further said that whether the indorsement was genuine or not was not important because even if it was a forgery B had a pledge interest in the certificate. He further said that, although C had realized on the securities (considered as a whole, deposited with C by B) more than enough to satisfy C's claim against B, A was not entitled to recover the surplus (up to the amount of the proceeds of the sale of the certificate for ten shares) because the evidence did not establish that A owed B nothing, and that "this being an action for conversion [A] must show either possession or the right to possession of the thing alleged to have been converted, and he has shown neither. The evidence leaves [B] still entitled to the possession" (p. 300). Therefore the judgment was reversed and a new trial granted.

Mr. Presiding Justice John M. Kellogg concurred only in the result.

Mr. Justice H. T. Kellogg dissented. The principle of *McNeil v. Tenth National Bank* (our p. 263) did not apply. The C in that case was protected only by estoppel, and the burden of proving estoppel was upon C. In the case at bar he had not done so. "It was for C to have proved that this name was signed by A. Having failed to do so A was entitled to a recovery. Doubtless if the action had been against B he might have pleaded and proven an indebtedness on the part of A to him in reduction or mitigation of damages. C, however, was a stranger to A; C could not prove in his own defense the debt owing to B. A owes C nothing. If C offset the claim of B against the damages to A, there is no reason why B should not then sue A on A's debt to B and have a

full recovery. In any event there is no proof as to the extent of the indebtedness of A. A was not obliged to tender the amount of the debt before suit. It must clearly follow that he was not obliged to establish the amount of the debt against himself. The suggestion that the conversion was merely of his interest in the property, which was the legal title less a debt held against it is ingenious but unsound (*Hammer v. Wilsey,* 17 Wend. 91). The evidence established without contradiction a conversion of the stock of A. He was, therefore, entitled to a direction of a verdict for the value thereof" (p. 301; A, B and C have been substituted for the actual names).

Comment:

1. Whether B was or was not the agent of C, the act of repledging to C was a conversion. A was entitled to recover from B the value of the stock, less the debt. That is to say, B had converted A's pledgor's interest. It did not clearly appear that A was not indebted to B in any amount, therefore a direction of a verdict for A against B for the full value of the stock would not have been justified. And A should not have been entitled to a directed verdict against C for a larger amount than he was entitled to as against B. Therefore the *result* reached by the majority — the granting of a new trial — was right.

2. But the majority proceeded to justify that result on the alternative ground that, as this was an action for conversion, A could not maintain the action since a plaintiff suing for a conversion must show either possession or the right to possession of the thing alleged to have been converted. This is all wrong. This is poison from the *Gordon v. Harper* decision (see our pp. 152–159). It is contrary to the idea that a pledgor may sue for the conversion of his pledgor's interest. Even Massachusetts allows that (the *Boston Terminal Refrigerating* case, our p. 163). It is squarely contrary to the result reached in New York in many other cases.

Even the dissenting judge fell into similar error.

And the court even went so far as to say that the plaintiff could not recover proceeds of the sale of the pledgor's interest.

3. Whether C had independent or only derivative rights turned

on whether the signature was genuine or not. That question should have gone to the jury. If the jury should find that the signature was genuine, judgment would then go to the defendant. If the jury should find that the signature was forged, of course C's sale was a conversion, not of the stock, but of A's interest therein.

4. A depressing case. Both opinions are, in important respects, out of joint with repeated decisions by the Court of Appeals.

Brightson v. Claflin, 225 N. Y. 469, 122 N. E. 458 (1919)

A pledged stock to B. B collected dividends thereon but did not apply them in reduction of A's debt. Thereafter B sold the stock *and* the proceeds of the dividends. B had no right to sell the proceeds of the dividends and his misconduct infected the sale of the pledged stock, which under proper conditions might have been sold. Inasmuch as part of the entire transaction was unlawful, the whole of it necessarily became so.

White v. Slayback, 189 App. Div. 564, 178 N. Y. S. 421 (1919)

An allegation that the defendants upon consideration agreed to carry the account of the plaintiff " for a reasonable time " and " see her through " is too indefinite and uncertain to be the basis of a claim.

People v. Atwater, 229 N. Y. 303, 128 N. E. 196, 38 N. Y. Cr. 419 (1920)

A firm of stockbrokers, which was taking from its customers subscriptions to Liberty bonds, in small lots, subscribed at a national bank for a number of such bonds, to be thereafter issued, and paid the initial per cent required by the government. In order to get the bonds, when issued, the firm gave its collateral note for the balance due on the bonds and gave its check for the amount with instructions to use the money to take up the bonds, and the bonds, when issued, were held as security for the note. When the note became due the defendant, a member of the firm, gave a renewal note for the same amount reciting therein that the bonds were pledged for its payment. The customers had, in the meantime, paid defendant's firm for their bonds and as against it

were entitled to immediate possession thereof. Subsequently it appeared that the firm was insolvent. When the renewal note became due, the bonds held by the bank as collateral were sold to satisfy its pledge interest and the subscribers lost the money which they had paid the firm for such bonds. Held, that the defendant in pledging the bonds for the payment of the renewal note was guilty of a felony within the meaning of the statute (Penal Law, Sec. 956 [1]) and that it was error for the Appellate Division to reverse the judgment of conviction, on the ground that neither the defendant nor his firm had possession of the Liberty bonds which it hypothecated as security for the renewal note because the bank did not surrender the custody and control thereof to him, but kept them, as it held them, as security for the loan it had previously made to defendant's firm. In legal effect the defendant received the bonds from the bank and delivered them anew to the bank when the new note was given and such rehypothecation was a renewal of the original offense.

Heaphy v. Kerr, 190 App. Div. 810, 180 N. Y. S. 542 (1920), affirmed without opinion 232 N. Y. 526, 134 N. E. 557 (1920)

The facts were similar to those in *Wood v. Fisk* (our pp. 225–226). A pledged to B, B repledged to C for a larger amount. B

[1] A person engaged in the business of purchasing and selling as a broker stock, bonds or other evidences of debt of corporations, companies or associations, who

1. Having in his possession, for safe keeping or otherwise, stock, bonds, or other evidences of debt of a corporation, company or association belonging to a customer, without having any lien thereon or any special property therein, pledges or disposes thereof without such customer's consent; or

2. Having in his possession stocks, bonds or other evidences of debt of a corporation, company or association belonging to a customer on which he has a lien for indebtedness due to him by the customer, pledges the same for more than the amount due to him thereon, or otherwise disposes thereof for his own benefit, without the customer's consent, and without having in his possession or subject to his control, stocks, bonds, or other evidences of debt of the kind and amount to which the customer is then entitled, for delivery to him upon his demand therefor and tender of the amount due thereon, and thereby causes the customer to lose, in whole or in part, such stocks, bonds, or other evidences of debt, or the value thereof,

Is guilty of a felony punishable by a fine of not more than five thousand dollars or by imprisonment for not more than two years, or by both.

Every member of a firm of brokers, who either does, or consents or assents to the doing of any act which by the provisions of this or the last preceding section is made a felony, shall be guilty thereof.

broke, and C made an authorized liquidating sale. A sued B, and B pleaded a discharge in bankruptcy. Held, that since the passage of Section 956 of the Penal Law (note 1, p. 335) such repledge must, unless authorized, be deemed a willful and malicious injury to property within the meaning of the Bankruptcy Act and therefore was excepted from the immunity of a discharge in bankruptcy.

B claimed that A had consented to the repledge. As to this the court said: "The defendants insist, however, that this repledge was by the consent of the plaintiff. In this case the evidence of the plaintiff was in no way contradicted by any evidence from the defendants. The plaintiff swears to explicit instruction not to repledge his property. He swears again later during the pendency of his transactions with the defendants of his notification to the manager of one of the branch houses that his securities must not be pledged. His consent is not claimed to have been given specifically. It was not sworn to by any one. The only evidence which is claimed to support the defendants' contention is found in the reports made by the defendants to plaintiff of purchases made by the defendants for the plaintiff in the course of these transactions. Upon each one of these reports the main part of the report is in large type. Upon the bottom of the report in smaller type appears the following: 'It is hereby mutually understood and agreed, waiving all notice, that the sale or purchase of all stocks, bonds, securities or contracts in your account, at public or private sale, is authorized, when such sale or purchase is deemed necessary by us for our protection, and that all securities deposited for the protection of your account may be pledged by us as collateral to our own loans. Yours Respectfully, Kerr & Company.' Now, the learned court charged the jury that if the plaintiff read these notices, *or if he should have read them,* by failing to dissent, he gave the consent required by the statute to authorize the repledging of these securities. The plaintiff swears that he never read these notices or knew what they contained. We are referred to no cases and I have been able to find none where in a notice of a purchase by a stockbroker there can

be included in smaller type a new contract which will be deemed impliedly agreed to if a dissent be not expressed. The cases have held that in a proposed contract, matter expressed in smaller type and in an insignificant space must be read by the party executing it. He has a duty to read carefully before executing the contract. But that is because he is then making his contract. Here he was merely receiving notices of purchases by the brokers. He was making no contract and signed nothing. No one has reason to expect that in the mere notice of the purchase of stock the broker is inveigling him into some further contract as to rights in collateral which he would not otherwise possess. It is not unnatural for a busy man to take up that report and read the matter of the purchase and not to read the matter in small print at the bottom of the notice. With proof positive that he did not read them, and with no legal obligation to read them, there can be no implied consent to the making of a new contract by reason of his failure to express dissent therefrom. The more honorable dealing would be to procure a written consent, or at least an express consent, if it were intended to claim the right to repledge these securities for their own debts. The attempt to procure an implied consent by reason of such notices attached to their notice of purchase of stock is not to be commended by courts as a matter of upright dealing. Again, if an implied consent may be deemed sufficient, that implied consent must be upon facts that leave no mistake that the party against whom the consent is implied intended to give it. While this notice, critically read, would probably be interpreted to consent to the repledge of securities for the general debts of the broker, it might easily be interpreted by those less trained in the law to refer only to such pledges as might be necessary to obtain the moneys by the brokers for the carrying of the customer's account, and the words 'our own loans,' when read in connection with the rest of the notice, might be interpreted as being 'our own loans made necessary for the purpose of carrying the customer's account.' That this notice is not so clear that one who runs may read, is shown by the fact that the jury, after having these papers before them in the jury room, and through the

trial, came back to the court and asked the proper interpretation of the words there used. In my opinion, as a matter of law, the contract there claimed is not so plainly expressed as to authorize any implication of a consent to the repledging of the customer's securities for the general loans of the brokerage firm" (p. 812).

Comment:

That part of the opinion dealing with "consent" puts the law on a sound basis. Of course it is bad for the stockbrokerage business to open the eyes of margin customers to the *double* risk they are taking, — the risk (1) that the stock purchased may fall, and (2) that B (not A) may default and that A's property rights may be annihilated through a liquidating sale by C. But "constructive" consent should not be enough. There should be an intelligent, conscious consent.

Gouert v. Mechanics & Metals National Bank, 191 App. Div. 854, 182 N. Y. S. 579 (1920), affirmed without opinion 233 N. Y. 576, 135 N. E. 924 (1922)

A was a margin customer of B. B pledged to C A's securities and other securities which X had deposited with B for safekeeping. C sold X's securities and delivered to A some of A's securities not necessary to satisfy C's claim. The court held that X had no cause of complaint against C, but did have the right to have the remainder of A's securities applied to the payment of the balance due, and a prior right to any surplus that might remain (to the extent of the value of X's securities). When A received the securities from C he took them *cum onere* the rights of X. "The amount that [A] paid to redeem the stock had been reduced by the amount of the proceeds of [X's] bonds which had theretofore been applied. [A] has thus been unjustly enriched to that extent and must account therefor to [X]" (p. 865).

Niles v. Havens, 198 App. Div. 546, 190 N. Y. S. 656 (1921)

B pledged A's securities to C, but there was no proof that they were pledged for more than the debt of A to B. B broke, and just what happened to the stock thereafter is not stated. A sued

B for a conversion, B pleaded a discharge in bankruptcy, and the court held that it was a bar.

Comment:

Of course. No claim in tort had been substantiated.

Rumery v. Brooks, 205 App. Div. 283, 199 N. Y. S. 517 (1923)

X purchased five United Kingdom of Great Britain and Ireland five and one-half per cent notes through B, and left them in B's possession. A deposited with B three other notes of the same kind as security for a marginal account which A intended to open, but before A had made any purchases B failed. X demanded from B his five notes and B delivered to him five such notes, but two were notes deposited by A. A sued X for the conversion of these two notes. The court held that A's right to receive his identic notes at all times remained in him, and that X was a converter. X claimed that the duty of B to deliver five such notes constituted an " antecedent or pre-existing debt " within the meaning of Sec. 51 of the Negotiable Instruments Law, and that he was a bona fide holder. Untenable.

Comment:

A's right was to receive his identic notes. But X took them in discharge of a duty by B to give X his identic notes. As to whether or not he was not protected under Sec. 51 of the N.I.L. we express no opinion.

It may be noted that the court said that A gave the broker *the usual authority* to pledge in case he became indebted to them. This however was not pertinent since A had made no purchases. The court remarked, that, if the notes had become part of collateral for marginal transactions they would have become fungibles whose identity was lost.

Asylum of St. Vincent de Paul v. McGuire, 239 N. Y. 375, 146 N. E. 632, 38 A. L. R. 1214 (1925)

The treasurer of A was also a member of a firm of stockbrokers, B. Bonds belonging to A were pledged by B to C, a bona fide pledgee. Part of the collateral given by B to C were securities deposited by X with B for safekeeping. Held, that the equities of

A and X were equal, and that whatever securities or proceeds of sale of securities by C remained in C's hands after the B, C debt had been satisfied belonged in equity to A and X in a proportion to be determined by their respective values.

Rogers v. Thomson, 215 App. Div. 541, 214 N. Y. S. 193 (1926)

Did the complaint state facts sufficient to constitute a conversion? A, in certain counts, alleged that B made a tortious pledge to C, but did not allege that A had later made tender and demand.

The court said: "The foregoing authorities sustain the principle already noted that shares of stock purchased by a broker must not be pledged, except in such a manner that immediate possession may be had upon tender of the amount due from the customer unless the broker has in his possession a like amount for delivery to the customer. Before an action in conversion, however, can be maintained against such broker, it is necessary for the plaintiff to show a demand and tender of amount due.

"The valid objection to the second and third causes of action, is, therefore, that the plaintiff has failed to show a demand and tender of amount due to [B] and hence no conversion as to them is alleged" (p. 547).

Comment:

Here is an idea reminiscent of Judge Cardozo. The conversion or at least the "real" conversion does not occur on the tortious transfer, but only on failure to deliver on tender and demand.

We submit that this is plainly wrong. A tortious repledge is, *without more,* a conversion. Demand and refusal are relevant only with respect to conversions by tortious withholdings (our pp. 118–123.

Chandler v. P. W. Chapman & Co., Inc., 218 App. Div. 773, 218 N. Y. S. 604 (1926)

In an action for conversion of stock, the plaintiff did not allege demand and refusal. This did not make the complaint demurrable.

Comment:

Contrast this decision, which we submit was correct, with the case of *Rogers v. Thomson,* immediately preceding.

Rosenthal v. Brown, 247 N. Y. 479, 160 N. E. 921 (1928)

Where, in an action to recover for the closing out of plaintiff's account without proper notice to him, it appeared that plaintiff had, through defendants, sold cotton on contracts for future delivery on a margin and been notified by defendants to put up more margin before publication of the government report the next morning, but that in a telephone conversation defendants' margin clerk had told him that it " would be all right if he got it around before twelve o'clock," and that the next morning plaintiff with bonds and cash arrived at defendants' office at 11:10 o'clock and was informed that he had been sold out, notice of their intention so to do on or before 10:45 o'clock having been left at plaintiff's office at about 10:30 o'clock, in face of a finding that the notice was not reasonable, a dismissal of the complaint was error. Defendants' promise to give plaintiff until noon to put up the additional margin was a definite extension of time and they were bound to give reasonable notice of their intention to retract.

Klapp v. Bache, 229 App. Div. 415, 242 N. Y. S. 155 (1930), affirmed without opinion 255 N. Y. 550, 175 N. E. 308 (1930)

Under a customer's agreement which authorized a broker to sell securities purchased on margin whenever deemed necessary for his protection " without demand for margin " or notice of sale, " which are expressly waived, and no specific demand or notice shall invalidate this waiver," notice to the customer of contemplated sale by stop loss orders was a specific notice of sale within the said agreement.

The customer having expressly waived notice of sale, and having expressly agreed that no specific notice of sale that might be given should invalidate this waiver, the brokers were entitled to rely upon the strict terms of the agreement and were not guilty of conversion when they sold the securities after notice to the customer of proposed stop loss orders.

The brokers are not estopped from relying upon the strict

terms of the agreement, for they had no reason to believe that the notice of stop loss orders would influence the conduct of their customer nor was there any duty to speak before proceeding under the strict terms of the agreement.

Wills v. Investors Bankstocks Corp., 257 N. Y. 451, 178 N. E. 755, 78 A. L. R. 1013 (1931)

Plaintiff contracted for the purchase of certain stocks at a stated price with a third party, who, in turn, contracted with defendant for the stocks at a lower price, notifying defendant that the purchase was to fill the order from plaintiff, enclosing checks for the purchase price and directing defendant to transfer the stocks to plaintiff's name. Defendant acknowledged the checks by letters stating " we have this day placed ' the stocks ' in transfer into the name " of plaintiff. The statement was false as the stocks had not been delivered to defendant, though purchased. Before defendant received the stocks, the third party became bankrupt, owing defendant a large sum of money, whereupon defendant refused to deliver the stocks to plaintiff, though it retained the purchase price. In these actions for conversion, plaintiff cannot recover. The title had not passed to the plaintiff.

In Re Salmon Weed & Co., Inc., 53 F. (2d) 335, 79 A. L. R. 379, Circuit Court of Appeals (Second Circuit, 1931)

Although this case was in a federal court, it is inserted here rather than in Chapter X because of its exposition of New York law.

In 1929 B bought stock for the account of A, and held the stock to secure a debt of about $28,000. B tortiously pledged this to C, a bank, as part of the collateral for a loan of $100,000. A became bankrupt, and B filed a proof of claim for the amount due from A less the value of the stock (which had fallen in value). The receiver in bankruptcy opposed the allowance, — one ground being that the repledge was a conversion and that the damages for the conversion exceeded the amount of the debt.

Two questions were therefore presented: (1) Is a tortious pledge (as distinguished from a tortious sale) a conversion; and (2), if so, what is the proper measure of damages?

The answer of the court to the first question was "Yes."

It said: (1) "It is certainly hard to see why such a repledge is not an exercise of dominion over the pledgor's property, so inconsistent with his rights as to amount to a conversion and to justify such actions [trover or detinue]. The pledgee has used the property as though it were his own and has subjected the pledgor's interest to an added risk.

(2) "Yet in England it seems to be settled that such an act is not in itself a conversion and that trover will not lie without a demand and tender of the amount of the original loan and a failure to surrender the pledge. *Donald v. Suckling,* L. R. 1 Q. B. 585; *Halliday v. Holgate,* L. R. 3 Ex. 299.

(3) "It is difficult to explain why a pledgor may not recover in trover without tender and demand, when there is a wrongful rehypothecation, while he may bring trover in case of an unlawful sale of property, subject to a lien or pledge, without the performance of any such condition (authorities). One cannot see a substantial difference in the risk to the customer whether the broker resells the security or repledges it in a large bank loan. In either event the broker may be able to get equivalent shares of stock for delivery — in the one case by purchase in the market, and in the other by paying off enough of his bank loan to withdraw the stock. But in neither case would he hold shares certainly available for delivery."

After reviewing some authorities outside of New York as to whether a tortious repledge was a conversion the court said: (4) that the New York decisions are "in some confusion," that in *Douglas v. Carpenter* (our p. 220), the Appellate Division in the First Department held that it was a conversion and that no demand and tender were necessary; but that in *Mayer v. Monzo* (see the case on appeal at our p. 328) in the Appellate Division in the same department "an exactly opposite result was reached" and that *Rogers v. Thomson* (our p. 340) was another decision of the First Department to the same effect as *Mayer v. Monzo;* but *Heaphy v. Kerr* (see the case on appeal at our p. 335) was a decision of the Appellate Division, Third Department, that it *was* a conversion. "Whether a demand and tender are necessary before an excessive repledge can be regarded as a conversion has not been

decided by the New York Court of Appeals. In *Wood v. Fisk* . . . Judge Cardozo discussed the question. He said that a repledge of securities for an amount in excess of the original loan 'may have constituted a conversion,' but, in any event, was 'a breach of contract.' That is as far as the Court of Appeals has gone. The wrong arising out of such a breach of contract would be a violation of the implied promise to hold the securities only for the purpose of the contract of pledge. But if the shares of stock were returned there would ordinarily be no substantial damages for the breach. Accordingly the important question in the present case is whether a repledge for an excess amount *in itself* (italics supplied) constitutes a conversion. While the Appellate Divisions have uttered discordant notes and the Court of Appeals has not yet spoken on this precise question, American courts in general, and the New York courts in particular, have been almost unanimous in holding that a sale by a pledgee contrary to the terms of the agreement is a conversion and that trover will lie without a tender and demand. In reason the same rule should apply to a repledge for an excessive amount.

(5) " This is not the law in England where a demand and tender must be made not only against a subpledgee (*Donald v. Suckling*), but likewise against the pledgee himself even when he has unlawfully sold the pawn. *Halliday v. Holgate,* L. R. 3 Ex. 299. . . .

(6) " There is a special reason for treating a repledge for an amount greater than the original loan as a conversion where as in New York there is a statute (Penal Law N. Y. Sec. 956) making such an act a felony if the broker shall cause his customer loss because of inability to deliver the latter's stock. . . . Certainly the legislative policy as to rehypothecation by a broker of a customer's stock to secure amounts in excess of his own advances is very clear. Unless consent of the customer is obtained, the transaction is undoubtedly illegal, and if loss ensues it is a felony. How can it be said that it is not a conversion?

(7) " There is another reason for holding that a repledge for an amount in excess of the original loan is a conversion. If such a repledge is only a conversion where there is financial inability

to meet [in the official report the word is not " meet " but " make," but this must be a mistake] a tender, a wrongful repledge will rarely affect a solvent broker. He can go merrily on in fair weather using his customers' stocks as capital in his business, whereas when storms arise such unlawful repledges are certain to cause losses to creditors who have given no authority to repledge their stocks beyond the amount of their own indebtedness. In other words, to impose no liability upon a broker for such unauthorized acts tempts him to risk his customers' property in good times for his own advantage and to make his customers bear his business losses if he becomes insolvent. The most practical way to check such wrongs is by treating brokers who have used their customers' securities without the latter's consent as converters. This on principle they certainly are."

Before passing to the second question (measure of damages) we interject comment.

1. What the court says in those parts of the opinion which (for convenience of reference) have been numbered (1), (3), (4), (6) and (7) brings the author to his feet, cheering at the top of his voice. His thoughts are in perfect harmony with the thoughts of the court, both as to the result and the reasons for that result. The opinion is powerful, persuasive, unanswerable. It is like a sun breaking through a fog.

2. We think that in those parts of its opinion numbered (2) and (5), the court was needlessly troubled. In *Wood v. Fisk*, Judge Cardozo referred to *Donald v. Suckling* as authority for the proposition that a tortious repledge would expose the pledgee to a liability for nominal damages, and no more, " where the securities are redeemed and restored to the customer upon demand," and Judge Augustus Hand (who wrote the opinion in the *Salmon Weed* case) apparently took it for granted that Judge Cardozo would not have said that unless it were so. But we have already shown (pp. 246–247) that it was not so.

In that case the only question was whether a tortious repledge by B to C destroyed the pledgee's right *in rem*. Three of the four judges held that it did not. It followed inevitably that A was not entitled to the possession until he made a proper tender

and thereby extinguished the right *in rem* (pp. 17–18). A was attempting to hold *C* as a converter on the ground that he had tortiously *withheld* the pledge (the second species of conversion, p. 118), and since the pledge interest had not been forfeited, the withholding was not tortious. In a word, it was *not* like *McCombie v. Davies* (p. 190). That is all there was to it. The fight was over forfeiture or no-forfeiture. Once it was decided that there was no forfeiture, the rest was routine.

If A, on the facts in *Donald v. Suckling,* had sought to hold B (not C) liable for a conversion constituted by the tortious *transfer* from B to C on pledge (the third species of conversion, p. 118), a very interesting question would have been presented. We incline to think that B should be held as a converter, since he has disposed of A's property, — has set it afloat on a sea of persons, strangers to A, but we do not feel at all sure how, say, Mr. Justice Blackburn would have decided that. But that question, although interesting, is immaterial. In *Donald v. Suckling* the security was *second-class* (p. 204), while in *Wood v. Fisk* and in the *Salmon Weed* case the security was *first-class.* In *Donald v. Suckling,* B made A chase after his property, but A had some property to chase. But in *Wood v. Fisk* and the *Salmon Weed* case, C gets independent, not merely derivative, rights, and therefore A's property is put in jeopardy, — his title may be swept away by a liquidating sale by C following upon a default by B (not himself, A). Surely, a tortious transfer involving such a risk should be distinguished from a tortious transfer where there is no such risk. Possibly, if there is no such risk, the tortious transfer may be called a trifling, minor tort, but who is there who cares to advocate the idea that a tortious transfer involving such a risk is a mere trifling, minor tort?

In a word, *Donald v. Suckling* had nothing to do with the case. Judge Hand was needlessly bothered by it and Judge Cardozo's comments on it.

A similar remark applies to *Halliday v. Holgate.* That was a case where B had made a tortious transfer by a delivery under an unauthorized liquidating sale. A was bankrupt, and the representative of A's creditors sought to hold B liable as a converter

for the full value of the property and to remit him to a claim, along with other unsecured creditors, against the bankrupt estate on A's debt. That same question had a short time before been presented in *Johnson v. Stear* (the first decision in the modern law of pledge, p. 196). One will see the start of the modern law of pledge if he *contrasts* the decision in *M'Combie v. Davies* (p. 190) with the decision in *Johnson v. Stear*. In the first case it was held that a tortious transfer by a lienee (p. 14) did forfeit the right *in rem;* in the second case it was held that a tortious transfer by a pledgee did *not* forfeit the pledgee's right *in rem.*

Now, in *Halliday v. Holgate* the plaintiff raised that question again (in *Johnson v. Stear* there had been a dissent). He urged the court to follow the lead of *M'Combie v. Davies* rather than the lead of *Johnson v. Stear*. This the court refused to do, stating its approval of the latter case in no uncertain terms.

Then counsel for the plaintiff sought to save his face by getting *nominal* damages. In *Johnson v. Stear,* nominal damages had been given, but that (if we read correctly between the lines) was because shrewd counsel for the defendant (against whom there had been a judgment at the trial) practically invited the court to award nominal damages against his client (see p. 199), — in other words, he saw that it was wise not to ask for judgment for his client but only to ask that the damages be reduced from full to nominal.

When the same question came up again in *Halliday v. Holgate,* the court was now travelling a road which had been opened by *Johnson v. Stear,* and it only did what may fairly be called a little mopping up by denying the plaintiff even nominal damages.

We concede that the court was not as careful in its language as it might have been and that its language lays some basis for contending that the *Gordon v. Harper* poison (pp. 152–159) was affecting its mind. But the simple and sufficient answer to the plaintiff's plea for nominal damages was that there was no proof that the value of the pledge was greater than the amount of the debt. Therefore, what *Halliday v. Holgate* stands for is that a defendant pledgee cannot be guilty of converting the pledgor's interest if there is no such interest to convert.

While it seems clear to us that Judge Hand was needlessly

troubled by these two cases, yet in a way we are glad that he was troubled. It seemed to him so plain that a tortious repledge, putting the customer's title in jeopardy, was a conversion that he so decided, although he thought he was going contrary to two important English cases, one of them (*Donald v. Suckling*) second in fame to no other English case on the law of pledge.

We now come to the second question: What was the proper measure of damages? A's pledgor interest has been converted. The measure of damages is therefore the value of the pledge less the amount of the debt. But *as of what date* is the pledge to be valued? That is the crucial question.

In the first opinion the court had said: "The damages for such a conversion are the highest intermediate value of the stock between the time of the conversion and a reasonable time after the owner has received notice of it (authorities). The pledgee is liable for those damages, but is entitled to recoupment to the extent of the amount due upon the loan." Therefore (in the case at bar) if A's debt to B were greater than the value of the pledge, B's proof of claim should be received.

But on a rehearing, the court modified its opinion on the measure of damages. It said: "A person whose property is converted may recover at least its value at the time of conversion (authorities). But where the property consists of fluctuating securities like stocks which have advanced in price since the date of notice of the conversion, this measure of damages is inadequate because insufficient to restore the owner to the position he would have been in but for the conversion. He should therefore be given a reasonable opportunity after he has received notice of the conversion to purchase similar securities in the market. If such securities sold for a higher price between the date of the conversion and the time when he received notice of the wrong than they did during a reasonable time after such notice, he ought not to recover this higher price for, *if he had desired to dispose of them in that interval,* (italics supplied) he would have learned of the conversion. Inasmuch as he has shown no desire to realize any value

which his securities reached prior to notice of the conversion, he is given complete indemnity and put in the same position that he would have been in except for the conversion if he is allowed the market value of the stock at the time of the unauthorized hypothecation or the highest price between the date when he received notice of the conversion and a reasonable time within which he might have replaced his stocks after he learned of the wrong, whichever may be higher.

"Our original opinion should be modified by allowing, as damages for the conversion, the market value of the stock at the time of the unauthorized hypothecation or the highest intermediate value of the stock between *notice* (italics in the original) of the conversion and a reasonable time thereafter whichever may be higher."

We cannot support this measure of damages. Our objection goes deep. We have said, and shall keep saying, that the *fundamental* question in margin-customer law is this: Has A property rights, rights *in rem,* or has he only contract rights, rights *in personam?* This is a question on which intelligent men have differed. We are convinced that A has property rights; that this view is in accord with the understanding of business men (indeed, the Massachusetts idea that the broker, not the customer, owns the stock, pp. 380–381, strikes them as fantastic); and that this view is also in accord with a general principle of law that he is owner who has the chance of gain and stands the risk of loss.

It is demonstrable that it is to the advantage of margin customers to have their *property* rights guarded. This is true both in cases where B does some wrongful act and also in cases where B becomes financially irresponsible.

Therefore, let each reader clear his mind once for all on this fundamental matter. Has A property rights? "Yes" or "No"?

If an American reader says "No," then we recommend that he take up his residence in Massachusetts (pp. 379–387). New York, after much careful consideration of the matter, said "Yes," and for decades (prior to *Wood v. Fisk*) it had never deviated from that, and had shown no disposition to change its answer. It

had given a lead which has been followed throughout the United States, Massachusetts alone excepted.

Then it follows that B's tortious transfer *is* a conversion. It may *also* be a breach of contract, in which case A should have his option (and a real, rather than a merely illusory, option) to sue either for a conversion or for breach of contract.

Assume A elects to sue for a conversion. Then cut out all breach-of-contract talk. That is the point. The court in the *Salmon Weed* case gave a hybrid rule, — half conversion, half breach of contract. A may have the " value " (we think the court was using this as though synonymous with " market price ") at the date of the conversion. But, except for that, he can only have damages based on a failure of B to have the wherewithal to make a delivery when A is minded to sell. That was *precisely* the thought of the *dissenting* judges in *Markham v. Jaudon,* which has certainly *not* been the law of New York for well over half a century.

Such reasoning is even fatal to allowing A to recover in contract the market price at the date of the wrongful act. True, if B received proceeds, A might recover such proceeds in indebitatus assumpsit (or the modern procedural equivalent) but that is upon the theory that A has waived the wrong. That is not a remedy for a tortious withholding or transfer.

We therefore feel justified in characterizing the *Salmon Weed* rule as a hybrid rule, half conversion and half breach of contract.

We said (p. 230) that there is a temple dedicated to the worship of a Janus-faced God, with a left-side conversion face and a right-side breach of contract face. We regret very much that the court in the *Salmon Weed* case entered that temple, but it did enter it. Perhaps the court did not advance to the altar but it certainly went over the threshold, and was " interested."

The damages where A sues for a conversion should be one hundred per cent conversion damages. The *Salmon Weed* rule does not give adequate conversion damages since those damages should be measured by " fair market value " rather than " market price " on a particular day. That the *Salmon Weed* rule disembowels the *Baker v. Drake* rule is demonstrable by considering the case of a tortious transfer made at a time of panic, followed by a

substantial market recovery. The *Salmon Weed* rule gives A no benefit of the rebound price. That is not market sense. We are here summarizing what we have said at greater length at pp. 269–273, but the matter is so important that we do not hesitate to reiterate.

The author has a profound respect for Judge Hand and treasures acquaintance with him. He believes Judge Hand will not take it amiss if he says that his sentiments about the *Salmon Weed* case are similar to those he experienced a good many years ago at a professional baseball game.

In an early inning, the shortstop for the home team had fumbled an easy double-play grounder, and before that inning was over three unearned runs had been scored by the opponents. The score stood at 3 to 0 until the last half of the seventh when the home team had three men on bases with two out and batter No. 4 at bat. Came a crack like the crack of a rifle, the ball went zipping into the outfield where neither centerfielder nor leftfielder could quite get it, and three pairs of red sox scampered across the plate. The ball was relayed to the third baseman. The runner rounded second and dashed for third. Would he make it? He had! The umpire's arms spread like a fan, with his thumbs doing the reverse Roman. Hurrah!

And then the momentum carried the runner beyond the bag and he was tagged out.

But he had made that smashing triple, he had batted in three runs, he had tied the score. There were no boos, only cheers, for him.

So with Judge Hand. The author is sorry about that *per curiam* opinion. But the thing which looms big in his mind is that mighty hit which Judge Hand made in the main opinion, — the best opinion on tortious repledges to be found in either the English or the American reports.

Hall v. Bache, 235 App. Div. 256, 256 N. Y. S. 693 (1932)

A was long 900 bales of May cotton. B made an unauthorized sale of A's cotton contracts. The court said: " The proof of this

conversion was well established" (p. 257). A who was then in Little Rock, Arkansas, learned of this about February 22. There were negotiations for a settlement, which came to nothing. The last interview was on March 9, and A then returned to Little Rock.

The trial judge instructed the jury that in measuring damages they might select any date prior to April 24. On appeal the parties stipulated that if A were entitled to recover the court might fix the reasonable time within which to compute the damage and determine the amount. The court said that A should be allowed a reasonable opportunity after March 9 "within which to determine whether he should repurchase the 900 bales of May cotton" (p. 258), and decided that the reasonable time expired on March 21.

Comment:

The trial judge acted on the *Baker v. Drake* rule (our p. 265). There was a difference between the trial judge and the appellate court as to the length of the reasonable time. The market had been rising, and consequently all that A wanted was to have as long a time as possible *after* he received notice on February 22; nobody was thinking about A's right to take advantage of a price between February 8 and February 22. Therefore we think it would not be fair to lay much stress on the charge by the trial judge.

Wilson v. Morley, 236 App. Div. 546, 260 N. Y. S. 124 (1932)

There is a dictum as follows: "The broker may be guilty of larceny and may be held in a civil action for conversion or misappropriation when without the consent of the owner he *pledges* (italics supplied) or disposes of stock owned by the customer, which is deposited as collateral security for a loan (authority) or as security for a margin account (authority)" (p. 547).

Woodward v. Schiff, 236 App. Div. 598, 260 N. Y. S. 274 (1932), affirmed without opinion 261 N. Y. 670, 185 N. E. 786 (1933)

B made a reasonable demand for more margin. A did not supply it. B sold on October 29, 1929 without giving notice of

time and place. Conversion, even if the market was in a frenzied condition.

Newton v. Wade, 264 N. Y. 632, 191 N. E. 600 (1934)

Where a stockbroker, in the absence of bad faith, offers to reinstate an account, the customer must either accept reinstatement or ratify and confirm the unauthorized sale.

Brown v. Garey, 267 N. Y. 167, 196 N. E. 12, 98 A. L. R. 1449 (1935)

A delivered to B, a firm of stockbrokers, a certificate for 65 shares of stock (presumably indorsed in blank) to be sold on the New York Stock Exchange. B without A's knowledge or consent, pledged it to C as part of the collateral for a loan of $250,000.

" The circumstances under which the conversion occurred were these: In defendant's New York office there were two hundred and fifty employees working under a systematized business organization, which was headed by an office manager. As part of the ordinary business of such a concern, the borrowing of money upon collateral which the firm had the right to pledge was a common occurrence. Under the system used in the office, securities not subject to hypothecation were marked definitely as to ownership and were placed for safekeeping in a custodian account with the Irving Trust Company. The other securities were kept in large drawers. When a loan had been arranged for, the collateral for the loan was made up by the loan clerks under the supervision of the chief loan clerk. The necessary securities needed for each loan were taken by the loan clerks from these drawers, under a general authority and without consulting any member of the firm in each particular instance. Securities so taken and used as collateral were not reported to any of the partners. The list of collateral to secure the $250,000, which included plaintiff's certificate, was made up and the securities taken from the drawer in the ordinary course of business. Neither the office manager nor the chief loan clerk could explain the inclusion of the plaintiff's certificate in that list. So far as appears, that list contained no other unauthorized pledge " (p. 170).

A majority of the court (Church, Ch.J., dissenting) held that giving A the benefit of all inferences which might be drawn from the evidence, the most that could be said was that the conversion was the result of negligence, and therefore that it was not "a willful and malicious injury to property" within the meaning of Section 17 of the Bankruptcy Act, and consequently that a composition in bankruptcy *was* a defense.

The court spoke of *Wood v. Fisk* (our pp. 225–256), saying: "Defendant brokers, authorized by plaintiff to repledge his collateral within a certain limit, exceeded that limit and the collateral was lost through sale by the subpledgee. So far as there was any willful conversion, it was held partial — since it left the general property in plaintiff — and technical rather than absolute and malicious. Since a wrongful intent is not an essential element of conversion (*Boyce v. Brockway,* 31 N. Y. 490, 493; *Laverty v. Snethen,* 68 N. Y. 522, 527), an act of dominion done under mistake or misapprehension and without conscious intent to violate right or authority, may yet be a conversion; but it is not a willful and malicious conversion. Even though the mistake or misapprehension is due to negligence, the rule can be no different" (p. 170).

It distinguished *Heaphy v. Kerr* (our p. 335) saying: "There the defendants hypothecated a customer's securities under circumstances which brought them within the terms of Penal Law, section 956, and made their act a felony. That seems reasonably clear, because their chief contention was that they were authorized by the customer to do what they did. It necessarily follows that they acted intentionally and with knowledge, and thus consented or assented to the hypothecation (*People v. Sugarman,* 216 App. Div. 209; affd., 243 N. Y. 638; *People v. Lowe,* 209 App. Div. 498). The relevant circumstances here include no such fact, and the finding of the Appellate Division to the contrary is without support in the evidence. That the defendants, under the office system adopted and used by them, did not in person select or supervise the selection of securities to be pledged, does not close the gap. There is no proof that the defendants personally knew of the acts of their employees prior to or at the time the unauthorized pledge was made; nor is there proof that their office system and

organization differed from that in common use so as to render likely or reasonably to be expected by them the unauthorized acts of subordinates. The possibility of a criminal conviction of defendants under Penal Law, section 956, on the evidence here is out of the question" (p. 171).

Sokol v. Harde, 247 App. Div. 193, 286 N. Y. S. 656 (1936), affirmed without opinion 273 N. Y. 569, 7 N. E.(2d) 696

B made purchase of stock for the account of A with A's authority. B also made a purchase which A claimed was unauthorized. B made a demand for more margin based on the idea that this particular purchase was authorized. A wrote to B refusing to pay in more margin, on the ground that the margin was ample for the stocks that had been purchased by his authority, and stating that he was prepared to take up the securities purchased by his authority when informed of the amount due. No formal tender of any money was ever made.

A recovered a verdict. A majority of the court (Glennon, J., dissenting) reversed this judgment. "To put the defendants in default when they were asserting an excessive lien, the proper amount of money due should have been offered or at least it must be shown that the plaintiff had the means to take up the stock and that a clear waiver of the necessity for a tender was evidenced by the conduct of the defendants" (p. 196).

Comment:

Here A claimed that B had converted, not by a tortious transfer (the third species of conversion, p. 118), but by a tortious withholding (the second species of conversion).

See *Scarfe v. Morgan*, 4 M. & W. 270, 1 H. & H. 292, 7 L. J. Ex. 324, 2 Jur. 569 (1838); but compare *Jones v. Tarleton*, 9 M. & W. 675, 1 Dowl. (N.S.) 625, 11 L. J. Ex. 267, 6 Jur. 348 (1842), *Folsom v. Barrett*, 180 Mass. 439, 62 N. E. 723, 91 Am. St. Rep. 320 (1902).

Ernst v. Miller, 162 Misc. 102, 293 N. Y. S. 819 (1937)

A employed B to purchase shares of X, when, as, and if issued at named prices. B purchased. A did not deposit any margin.

B sold for $1,750 less than he had paid and sued A to recover this, plus commissions and disbursements. Complaint dismissed.

There was no proof that A had agreed to deposit margin. The court said: " Instead of proving any such agreement, plaintiffs attempted to support their allegations in that regard by undertaking to offer evidence of the existence of a general trade custom which they claim to be applicable in the circumstances. Indeed, plaintiffs insisted upon the trial that an agreement to furnish adequate margin should be implied from the nature of their agency.

" A vital element in any agency or brokerage agreement is the method of payment. Payment may, of course, be made in divers ways. Regrettably, the plaintiffs failed to exercise the precaution of obtaining from defendant an express agreement determining the manner in which payment should be made. They entered upon the transaction without any such agreement.

" It is well understood that margin is generally referable to pledged securities. In a stock transaction the broker is usually furnished with margin sufficient to secure him against loss arising from the declining values of securities pledged with him. With respect to the stock, customer and broker stand in the relation of pledgor and pledgee, having rights and liabilities as such. Ordinarily, margin is furnished in connection with the hypothecation to the broker of securities of which the customer is already the owner. It is conceivable that a mere authorization to a broker to purchase stock, nothing else being said, carries the implication that the stock is to be pledged with the broker. It is, indeed, quite as likely that the purchaser intends to pay for the stock in full as soon as the same is obtained and tendered by the broker. It is also apparent that a customer cannot be compelled to accept the broker as the trustee of his goods and funds unless the customer expressly agreed to do so. Perhaps the customer would be unwilling to trust the broker to that extent.

" The only reasonable and logical inference flowing from the employment by defendant of plaintiffs as her brokers was an implied promise by defendant to pay to plaintiffs the money advanced for her account, together with the usual commissions and disbursements, upon the delivery to her of the stock purchased

for her account. Delivery and payment are concurrent conditions, even in an agency relationship, if no contrary intent be expressed. Naturally, pending payment, the stock is held by the brokers as security for the indebtedness arising from the purchase. In order to hold a customer liable upon an agreement to supply margin incidental to the purchase of securities, there must be either an express agreement to furnish margin or an agreement to hypothecate the securities or circumstances from which an agreement to margin may be implied. Here there was neither.

"A direction to a broker to purchase securities imposes upon the customer the obligation to pay the broker for the securities only when they are tendered to him. If the broker desires to receive the purchase price or any part thereof in advance of the purchase, he must exact an agreement entitling him thereto" (p. 103).

German v. Snedeker, 257 App. Div. 596, 13 N. Y. S.(2d) 237 (1939), affirmed without opinion 281 N. Y. 832, 24 N. E. (2d) 492 (1939)

B converted A's stock, and thereafter the stock fell. A was held entitled to have the stock valued as of the date of the conversion. "(A's) damages are based on the value of the stock *at the time of the conversion* (italics in the original) or within a reasonable time thereafter, whichever is higher" (p. 597).

But the court also said that the proper measure of damages "is the market value of the stock at the time of the unauthorized hypothecation, or the market value within a reasonable time *after notice* (italics supplied) of the hypothecation, whichever amount is the higher" (p. 597).

Comment:

On the facts no question was presented whether or no A could take advantage of a price between the conversion and notice thereof.

We give an index to these cases (a few of minor importance have not been included in the index).

1. The broker is pledgee, not owner. The margin customer has

rights *in rem* and not merely rights *in personam.* There are many authorities to this effect, including *Markham v. Jaudon,* p. 260; *Baker v. Drake,* p. 276; *Stratford v. Jones,* p. 283; *Tompkins v. Morton Trust Co.,* p. 301; *Content v. Banner,* p. 305; *Clappe v. Taylor,* p. 315; *Mullen v. Quinlan & Co.,* p. 316. See also *Ernst v. Miller,* p. 355.

2. The broker is not hedged with immunity by any "custom of the street." He stands before the common law like any other pledgee. *Markham v. Jaudon,* p. 260; *Lawrence v. Maxwell,* p. 264; *Baker v. Drake,* p. 276. "Custom of the street" was as dead as Jim Fisk up to Judge Cardozo's opinion in *Wood v. Fisk* (see p. 232).

3. If the broker wishes to be relieved from any of his common law duties, he must obtain the consent of the customer. Moreover, that consent must be a conscious, intelligent consent. *Brown v. Bronson,* p. 303; *Smith v. Craig,* p. 320; *Thompson v. Baily,* p. 322; *Heaphy v. Kerr,* p. 335.

4. A delivery made pursuant to an unauthorized sale is a conversion. The fact that the broker merely blundered, and was unconscious that he was doing something wrongful, does not save him from being a converter. What is converted is the pledgor-interest of the customer, — the value of the security less the debt. *Romaine v. Van Allen,* p. 257; *Markham v. Jaudon,* p. 260; *Strong v. National Mechanics Banking Association,* p. 263; *Porter v. Parks,* p. 264; *Baker v. Drake,* p. 276; *Content v. Banner,* p. 305; *Mullen v. Quinlan & Co.,* p. 316; *Smith v. Craig,* p. 320.

5. The law will support many (not all) agreements by a customer with the broker by reason of which the broker attains rights greater than the common law gives him. Thus the customer may waive demand for more margin, demand for payment, and notice of the time and place of sale. See *Wicks v. Hatch,* p. 275; *Williams v. United States Trust Co.,* p. 288; *Franklin National Bank v. Newcombe,* p. 291; *Klapp v. Bache,* p. 341. He may also authorize the broker to purchase himself. *Cammann v. Huntington,* p. 300. He may also authorize the broker to proceed according to "usages," and the usages may be proved by parol even if the

authority is in writing. *Baker v. Drake*, p. 276. And he may authorize B to repledge for a larger amount than his debt. *Ogden v. Lathrop*, p. 275.

6. If the broker makes an unauthorized sale it may be that the customer will by subsequent acts have ratified it. And if the customer fails to repudiate the sale within a reasonable time after notice he will stand the same as though he had ratified. *Hanks v. Drake*, p. 260; *Gillett v. Whiting*, p. 287; *Violett v. Horbach*, p. 309.

The law is muddy on several important points, there having been a great deal of mud since *Wood v. Fisk*.

7. Is a tortious repledge a conversion, a "technical" conversion, or no conversion at all? See *Lawrence v. Maxwell*, p. 264; *Hennequin v. Clews*, p. 279; *Capron v. Thompson*, p. 281; *Farwell v. Importers' Bank*, p. 282; *Douglas v. Carpenter*, p. 220; *Matter of Pierson*, p. 292; *Tompkins v. Morton Trust Co.*, p. 301; *Strickland v. Magoun*, p. 309; *Wood v. Fisk*, p. 225; *Mayer v. Monzo*, p. 328; *Gouert v. Mechanics & Metals National Bank*, p. 338; *Rogers v. Thomson*, p. 340. Note also *Taussig v. Hart*, p. 273.

8. What part does demand and refusal play in the law of conversion? We submit that it is the pith of the matter in that species of conversion which is a tortious withholding, but that it is immaterial in that species of conversion which is a tortious transfer. Some statements in the opinions support this, some do not. See *Taussig v. Hart*, p. 273; *Rothschild v. Allen*, p. 300; *Byrne v. Weidenfeld*, p. 306; *MacDonnell v. Buffalo Loan, Trust, and Safe Deposit Co.*, p. 310; *Mullen v. Quinlan & Co.*, p. 316; *Leishing v. Van Buren*, p. 331; *Rogers v. Thomson*, p. 340; *Chandler v. P. W. Chapman & Co., Inc.*, p. 340.

9. When an act is both a breach of contract and a conversion are damages always the same? In other words, is the option given to the person who has been wronged an option only as to labels? We do not seek to smother the fact that there are statements which, if taken at their language value, do reduce the option

to an option as to labels. See *Wright v. Bank of the Metropolis*, p. 284; *McIntyre v. Whitney*, p. 316.

10. What is the measure of damages when the pledgor's interest has been converted? See *Scott v. Rogers*, p. 257; *Baker v. Drake*, p. 265; *Wright v. Bank of the Metropolis*, p. 284; *Smith v. Savin*, p. 288; *Minor v. Beveridge*, p. 290; *Burhorn v. Lockwood*, p. 298; *Burnham v. Lawson*, p. 309; *Mayer v. Monzo*, p. 328; *In re Salmon Weed & Co.*, p. 342; *Hall v. Bache*, p. 351; *German v. Snedecker*, p. 357.

So much as to the rights between margin customer and broker. As to third persons:

11. A bona fide pledgee, C, has independent rights. *McNeil v. Tenth National Bank*, p. 263; *Thompson v. St. Nicholas Bank*, p. 286; *Smith v. Savin*, p. 288; *Brady v. Mount Morris Bank*, p. 297. But note *Taft v. Chapman*, p. 264; *Merchants' Bank v. Livingston*, p. 279; *Manhattan Savings Institution v. New York National Bank*, p. 297; *Hall v. Wagner*, p. 305; *Treadwell v. Clark*, p. 308. As to C's duty respecting the point mentioned in point 12, see *Smith v. Savin*, p. 288.

12. Where the securities of several persons have been pledged by B to C the rights of such persons, *inter se*, in the surplus (of cash or securities) remaining after the B, C debt is paid, are discussed in *Douglass v. Dudley*, p. 263; *Farwell v. Importers' Bank*, p. 282; *Franklin National Bank v. Newcombe*, p. 291; *Rhinelander v. National City Bank*, p. 293; *Tompkins v. Morton Trust Co.*, p. 301; *Gouert v. Mechanics & Metals National Bank*, p. 330; *Asylum of St. Vincent de Paul v. McGuire*, p. 339. But see § 60 of the National Bankruptcy Act as amended in 1938 (part of the so-called Chandler Act).

For cases involving some provisions in a Bankruptcy Act, see *Hennequin v. Clews*, p. 279; *Adams v. Ball*, p. 293; *Kavanaugh v. McIntyre*, p. 320; *Heaphy v. Kerr*, p. 335; *Brown v. Garey*, p. 353. For cases on Section 956 of the Penal Law of New York, see *People v. Atwater*, p. 334; *Heaphy v. Kerr*, p. 335. For cases where no "actual purchases" were made, see *Hurd v. Taylor*,

p. 304; *Haight v. Haight & Freese Co.*, p. 305. For cases involving transactions on the Cotton Exchange, see *Milliken v. Dehon*, p. 257; *Sanger v. Price*, p. 307; *Bosoian v. Hubbard*, p. 310; *Smith v. Craig*, p. 320; *Rosenthal v. Brown*, p. 341; *Hall v. Bache*, p. 351. For a case respecting an insurance policy, see *Toplitz v. Bauer*, p. 295.

The author has some things to say which are so elementary and so obvious to those who are adequately informed and who pause to reflect that they will seem banal to some. But there be those who do not pause to reflect.

1. The United States could not have developed its resources as effectively as it has done if the law had not furnished some means for combining small amounts of capital. A corporation is the usual means to that end. A $1,000,000,000 corporation may be composed of a million $1,000 stockholders. Many a mickle makes a muckle.

2. A corporation cannot be efficiently managed unless the powers of management are concentrated in the hands of a few persons. The directors occupy a position of great power. Not infrequently directors have feathered their own nests, been callous of the rights of stockholders and have even exploited stockholders.

3. At the present time there are many — a good many — directors of large corporations who have come to realize that their relation to stockholders is a fiduciary relationship, and who are making a sincere effort not only to run the corporation well but also to be decent to stockholders.

4. The New York Stock Exchange has contributed materially to the investment of large and small amounts in corporate securities. Few men are undisturbed if their investments are likely to become frozen. It is a powerful inducement to turn cash into stock if one feels certain that it will be easy to turn stock into cash. The broad, active market on the New York Stock Exchange has helped the United States to develop its resources.

5. The bulk of transactions on the New York Stock Exchange are not investment transactions but are speculative transactions. Speculation on the New York Stock Exchange has done a great

deal of harm. Many persons have been financially ruined. Many professional business men have been distracted from their work by their interest in the market, — they have tried to serve two masters with the usual result. And the widespread speculation has been a contributing cause to panics. What causes panics? Scared optimists. And there is no more scareable optimist than a speculator operating upon a slender margin.

6. At the present time the management of the New York Stock Exchange is making a sincere effort to keep speculation within limits and to see to it that each member of the Exchange is decent both to his fellow-members and also to his customers.

7. The supreme test of a man is this: Can he be trusted always to do the decent thing?

The Constitution of the New York Stock Exchange provides:

Article I, sec. 2. Its objects shall be to furnish exchange rooms for the convenient transaction of their business by its members; to furnish other facilities for its members and allied members; to maintain high standards of commercial honor and integrity among its members and allied members; and to promote and inculcate just and equitable principles of trade and business.

The present Rules of the Board of Governors include the following:

Rule 500. No member or member firm shall make improper use of a customer's securities.

Rule 501. No member or member firm shall lend, either to themselves as brokers or to others, securities held on margin for a customer unless such member or firm shall first have obtained a separate *written* (italics supplied) authorization from such customer permitting the lending of securities held for his account by such member or firm.

Rule 502. No agreement between a member or member firm and a customer authorizing the member or firm to pledge securities carried for the account of the customer either alone or with other securities, either for the amount due thereon or for a greater amount, or to lend such securities, shall justify the member or firm

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President of New York Stock Exchange

in pledging or lending more of such securities than is fair and reasonable in view of the indebtedness of said customer to said member or firm.

Rule 551. The Committee on Member Firms may fix the minimum amount of margin which must be required by members and member firms accepting margin accounts and the minimum amount of margin which such members must require on existing margin accounts.

The rules made by said committee include the following:

(a) Accounts Having Only " Long " Security Positions. The minimum margin in such an account shall be equal to at least 30% of the debit balance (Comment. This is a very different setup from that which formerly prevailed. See our p. 223).

(b) Accounts Having Only " Short " Security Positions. The minimum margin on securities " short " in such an account shall be equal to at least

(i) 100% of the market value, or $2.50 per share, whichever amount is greater, of each stock " short " in the account which has a market value of less than $5.00 per share; plus

(ii) 30% of the market value, or $5.00 per share, whichever amount is greater, of each stock " short " in the account which has a market value of $5.00 per share or over; plus

(iii) 30% of the market value, or 5% of the principal amount, whichever amount is greater, of each bond " short " in the account (G, 285).

The Committee on Member Firms has also provided: " When a member or member firm holds securities that have been fully paid for or holds securities in excess of the amount which can be pledged under Rule 502, such securities should be segregated and marked in a manner which clearly identifies the interest of each individual customer. When such securities are in the actual custody of the member or firm, this may be accomplished by placing them in separate envelopes bearing the customers' names or by attaching tags or labels, similarly marked, to the securities or by some other means which produces the same result. When such securities are not in the actual custody of the member or firm, their location

and the means by which they may be identified as belonging to the customers should be indicated on the books of the member or firm. The foregoing applies both to odd lots and full lots."

Dewitt C. Jones, Jr., Esq., of counsel to the Exchange, wrote to the author (January 27, 1941) as follows:

" The Exchange by its Rules requires its member firms to segregate not only fully paid-for securities of their customers when held by such firms but also to segregate excess margin securities and prohibits the repledge by the broker of more of his customer's securities than is fair and reasonable in the light of the customer's debit balance. By requiring member firms to have detailed periodic audits made as the basis for a questionnaire to be filed with the Exchange and by examinations of member firms by its own staff, the Exchange makes an earnest effort to see that these Rules are complied with at all times, and an intentional violation of such Rules on the part of a member firm is considered as a serious offense, subjecting the firm to disciplinary action.

" While at one time I understand that it was more or less the practice of brokers to rely upon a statement, with respect to their right to repledge a customer's securities, printed upon their confirmations of purchases and sales, this is not the case at the present time and it is the established practice of Stock Exchange firms, in the case of margin customers, to require the latter to sign a ' margin agreement,' which sets forth in considerable detail the rights of the parties. Many firms use for this purpose a form prepared by the Association of Stock Exchange Firms, a copy of which I enclose herewith for your information. Other firms, however, use their own forms, but these are practically the same in substance."

The form of the Customer's Agreement to which Mr. Jones referred is given as Appendix F. Note Clause 5.

(See also Regulation T adopted by Board of Governors of the Federal Reserve System prescribing *initial* margin requirements pursuant to Section 7 of the Securities Exchange Act, 1934, our p. 365. By a Supplement effective Jan. 1, 1938, the maximum loan value of a registered security is, as a general rule, 60 per cent of its current market value.)

Chapter X

TORTIOUS TRANSFERS OF FIRST-CLASS SECURITIES
(*Concluded*)

LEGISLATION AND DECISIONS IN JURISDICTIONS OTHER THAN NEW YORK

We divide the legislation and decisions in jurisdictions other than New York into three parts: first, the United States; second, all states excepting Massachusetts; and third, Massachusetts.

I. The United States

Legislation passed by the Congress and rules and regulations adopted by the Securities and Exchange Commission are of the first importance. The author rejoices and is exceeding glad that such legislation has been passed, and such rules and regulations adopted. Time was when he was only an unheeded voice crying in the wilderness. Now, what he once scarcely dared to hope for (see old notes in Property I) has become reality.

By the Securities Exchange Act, 1934, the Congress provided:

Sec. 5. It shall be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange within or subject to the jurisdiction of the United States to effect any transaction in a security, or to report any such transaction, unless such exchange (1) is registered as a national securities exchange under section 6 of this title, or (2) is exempted from such registration upon application by the exchange because, in the opinion of the Commission, by reason of the limited volume of transactions effected on such exchange, it is not practicable and not necessary or appropriate in the public interest or for the protection of investors to require such registration.

Sec. 8. It shall be unlawful for any member of a national securities exchange, or any broker or dealer who transacts a busi-

ness in securities through the medium of any such member, directly or indirectly . . .

(c) In contravention of such rules and regulations as the Commission shall prescribe for the protection of investors to hypothecate or arrange for the hypothecation of any securities carried for the account of any customer under circumstances (1) that will permit the commingling of his securities without his written consent with the securities of any other customer, (2) that will permit such securities to be commingled with the securities of any person other than a bona fide customer, or (3) that will permit such securities to be hypothecated, or subjected to any lien or claim of the pledgee, for a sum in excess of the aggregate indebtedness of such customers in respect of such securities.

(d) To lend or arrange for the lending of any securities carried for the account of any customer without the written consent of such customer.

Sec. 19. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors . . .

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this title or the rules and regulations thereunder, or has effected any transaction for any other person who, he has reason to believe, is violating in respect of such transaction any provision of this title or the rules and regulations thereunder.

Sec. 23. (a) The Commission and the Federal Reserve Board shall each have power to make such rules and regulations as may be necessary for the execution of the functions vested in them by this title, and may for such purpose classify issuers, securities, exchanges, and other persons or matters within their respective jurisdictions.

Sec. 32. Any person who willfully violates any provision of this title, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this title, or any person who willfully and

knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this title or any rule or regulation thereunder, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

The Securities and Exchange Commission (S.E.C.) has, pursuant to authority vested in it by the foregoing, adopted the following rules and regulations, effective February 24, 1941:

The Securities and Exchange Commission, deeming it necessary for the exercise of the functions vested in it and necessary and appropriate in the public interest and for the protection of investors so to do, pursuant to authority conferred upon it by the Securities Exchange Act of 1934, as amended, particularly Sections 8 (c), 3 (b), and 23 (a) thereof, hereby adopts the following rule:

RULE X-8C-1. *Hypothecation of Customers' Securities.*

(a) *General Provisions.* No member of a national securities exchange, and no broker or dealer who transacts a business in securities through the medium of any such member shall, directly or indirectly, hypothecate or arrange for or permit the continued hypothecation of any securities carried for the account of any customer under circumstances —

(1) that will permit the commingling of securities carried for the account of any such customer with securities carried for the account of any other customer, without first obtaining the *written* (italics supplied) consent of each such customer to such hypothecation;

(2) that will permit such securities to be commingled with securities carried for the account of any person other than a bona fide customer of such member, broker or dealer under a lien for a loan made to such member, broker or dealer; or

(3) that will permit securities carried for the account of customers to be hypothecated, or subjected to any lien or liens or claim or claims of the pledgee or pledgees, for a sum which exceeds the aggregate indebtedness of all customers in respect of securities carried for their accounts; except that this clause shall not be deemed to be violated by reason of an excess arising on any day through the reduction of the aggregate indebtedness of customers on such day, provided that funds in an amount sufficient to eliminate such excess are paid or placed in transfer to pledgees for the purpose of reducing the sum of the liens or claims to which securities carried for the account of customers are subjected as promptly as practicable after such reduction occurs, but before the lapse of one half hour after the commencement of banking hours on the next banking day at the place where the largest principal amount of loans of such member, broker or dealer are payable and, in any event, before such member, broker or dealer on such day has obtained or increased any bank loan collateralized by securities carried for the account of customers.

(b) *Definitions.* For the purposes of this rule —

(1) The term " customer " shall not be deemed to include any general or special partner or any director or officer of such member, broker or dealer, or any participant, as such, in any joint, group or syndicate account with such member, broker or dealer or with any partner, officer or director thereof:

(2) the term " securities carried for the account of any customer " shall be deemed to mean:

(i) securities received by or on behalf of such member, broker or dealer for the account of any customer;

(ii) securities sold and appropriated by such member, broker or dealer to a customer, except that if such securities were subject to a lien when appropriated to a customer they shall not be deemed to be " securities carried for the account of any customer " pending their release from such lien as promptly as practicable;

(iii) securities sold, but not appropriated, by such member, broker or dealer to a customer who has made any payment therefor, to the extent that such member, broker or dealer owns and has received delivery of securities of like kind, except that if such

securities were subject to a lien when such payment was made, they shall not be deemed to be "securities carried for the account of any customer" pending their release from such lien as promptly as practicable;

(3) "aggregate indebtedness" shall not be deemed to be reduced by reason of uncollected items. In computing aggregate indebtedness, related guaranteed and guarantor accounts shall be treated as a single account and considered on a consolidated basis, and balances in accounts carrying both long and short positions shall be adjusted by treating the market value of the securities required to cover such short positions as though such market value were a debit; and

(4) in computing the sum of the liens or claims to which securities carried for the account of customers of a member, broker, or dealer are subject, any rehypothecation of such securities by another member, broker or dealer who is subject to this rule or to Rule X-15C2-1 shall be disregarded.

(c) *Exemption for Cash Accounts.* The provisions of paragraph (a) (1) hereof shall not apply to any hypothecation of securities carried for the account of a customer in a special cash account within the meaning of Section 4 (c) of Regulation T of the Board of Governors of the Federal Reserve System, provided that at or before the completion of the transaction of purchase of such securities for, or of sale of such securities to, such customer, written notice is given or sent to such customer disclosing that such securities are or may be hypothecated under circumstances which will permit the commingling thereof with securities carried for the account of other customers. The term "the completion of the transaction" shall have the meaning given to such term by Rule X-15C1-1 (b).

(d) *Exemption for Clearing House Liens.* The provisions of paragraphs (a) (2), (a) (3), and (f) hereof shall not apply to any lien or claim of the clearing corporation, or similar department or association, of a national securities exchange, for a loan made and to be repaid on the same calendar day, which is incidental to the clearing of transactions in securities or loans through such corporation, department or association, provided, however, that for the purpose of paragraph (a) (3) hereof, "aggregate

indebtedness of all customers in respect of securities carried for their accounts " shall not include indebtedness in respect of any securities subject to any lien or claim exempted by this paragraph.

(e) *Exemption for Certain Liens or Securities of Noncustomers.* The provisions of paragraph (a) (2) hereof shall not be deemed to prevent such member, broker or dealer from permitting securities not carried for the account of a customer to be subjected (i) to a lien for a loan made against securities carried for the account of customers, provided the pledgee agrees that securities which it is informed are carried for the account of customers will be physically segregated from any other securities, or (ii) to a lien for a loan made and to be repaid on the same calendar day. For the purpose of this exemption, a loan shall be deemed to be " made against securities carried for the account of customers " if only securities carried for the account of customers are used to obtain or to increase such loan or as substitutes for other securities carried for the account of customers.

(f) *Notice and Certification Requirements.* No person subject to this rule shall hypothecate any security carried for the account of a customer unless, at or prior to the time of each such hypothecation, he gives written notice to the pledgee that the security pledged is carried for the account of a customer and that such hypothecation does not contravene any provision of this rule, except that in the case of an omnibus account the member, broker or dealer for whom such account is carried may furnish a signed statement to the person carrying such account that all securities carried therein by such member, broker or dealer will be securities carried for the account of his customers and that the hypothecation thereof by such member, broker or dealer will not contravene any provision of this rule. The provisions of this paragraph shall not apply to any hypothecation of securities under any lien or claim of a pledgee securing a loan made and to be repaid on the same calendar day.

The Securities and Exchange Commission, deeming it necessary for the exercise of the functions vested in it and necessary and appropriate in the public interest and for the protection of inves-

tors so to do, and finding that such action is reasonably designed to prevent fraudulent, deceptive and manipulative acts and practices, pursuant to authority conferred upon it by the Securities Exchange Act of 1934, as amended, particularly Sections 15 (c) (2) and 23 (a) thereof, hereby adopts the following rule:

RULE X-15C2-1. *Hypothecation of Customers' Securities.*

(a) *General provisions.* The term "fraudulent, deceptive, or manipulative act or practice," as used in section 15 (c) (2) of the Act, is hereby defined to include the direct or indirect hypothecation by a broker or dealer, or his arranging for or permitting, directly, or indirectly, the continued hypothecation of any securities carried for the account of any customer under circumstances —

(1) that will permit the commingling of securities carried for the account of any such customer with securities carried for the account of any other customer, without first obtaining the *written* (italics supplied) consent of each customer to such hypothecation;

(2) that will permit such securities to be commingled with securities carried for the account of any person other than a bona fide customer of such broker or dealer under a lien for a loan made to such broker or dealer; or

(3) that will permit securities carried for the account of customers to be hypothecated, or subjected to any lien or liens or claim or claims of the pledgee or pledgees, for a sum which exceeds the aggregate indebtedness of all customers in respect of securities carried for their accounts; except that this clause shall not be deemed to be violated by reason of an excess arising on any day through the reduction of the aggregate indebtedness of customers on such day, provided that funds in an amount sufficient to eliminate such excess are paid or placed in transfer to pledgees for the purpose of reducing the sum of the liens or claims to which securities carried for the account of customers are subject as promptly as practicable after such reduction occurs, but before the lapse of one half hour after the commencement of banking hours on the next banking day at the place where the largest principal amount of loans of such broker or dealer are payable and, in any event, before such broker or dealer on such day has ob-

tained or increased any bank loan collateralized by securities carried for the account of customers.

(b) *Definitions.* For the purposes of this rule —

(1) the term " customer " shall not be deemed to include any general or special partner or any director or officer of such broker or dealer, or any participant, as such, in any joint, group or syndicate account with such broker or dealer or with any partner, officer or director thereof;

(2) the term " securities carried for the account of any customer " shall be deemed to mean;

(i) securities received by or on behalf of such broker or dealer for the account of any customer;

(ii) securities sold and appropriated by such broker or dealer to a customer, except that if such securities were subject to a lien when appropriated to a customer they shall not be deemed to be " securities carried for the account of any customer " pending their release from such lien as promptly as practicable;

(iii) securities sold, but not appropriated, by such broker or dealer to a customer who has made any payment therefor, to the extent that such broker or dealer owns and has received delivery of securities of like kind, except that if such securities were subject to a lien when such payment was made they shall not be deemed to be " securities carried for the account of any customer " pending their release from such lien as promptly as practicable;

(3) " aggregate indebtedness " shall not be deemed to be reduced by reason of uncollected items. In computing aggregate indebtedness, related guaranteed and guarantor accounts shall be treated as a single account and considered on a consolidated basis, and balances in accounts carrying both long and short positions shall be adjusted by treating the market value of the securities required to cover such short positions as though such market value were a debit; and

(4) in computing the sum of the liens or claims to which securities carried for the account of customers of a broker or dealer are subject, any rehypothecation of such securities by another broker or dealer who is subject to this rule or to Rule X-8c-1 shall be disregarded.

(c) *Exemption for Cash Accounts.* The provisions of para-

graph (a) (1) hereof shall not apply to any hypothecation of securities carried for the account of a customer in a special cash account within the meaning of Section 4 (c) of Regulation T of the Board of Governors of the Federal Reserve System, provided that at or before the completion of the transaction of purchase of such securities for, or of sale of such securities to, such customer, written notice is given or sent to such customer disclosing that such securities are or may be hypothecated under circumstances which will permit the commingling thereof with securities carried for the account of other customers. The term " the completion of the transaction " shall have the meaning given to such term by Rule X-15C1-1 (b).

(d) *Exemption for Clearing House Liens.* The provisions of paragraphs (a) (2), (a) (3), and (f) hereof shall not apply to any lien or claim of the clearing corporation, or similar department or association, of a national securities exchange, for a loan made and to be repaid on the same calendar day, which is incidental to the clearing of transactions in securities or loans through such corporation, department or association, provided, however, that for the purpose of paragraph (a) (3) hereof, " aggregate indebtedness of all customers in respect of securities carried for their accounts " shall not include indebtedness in respect of any securities subject to any lien or claim exempted by this paragraph.

(e) *Exemption for Certain Liens on Securities of Noncustomers.* The provisions of paragraph (a) (2) hereof shall not be deemed to prevent such broker or dealer from permitting securities not carried for the account of a customer to be subjected (i) to a lien for a loan made against securities carried for the account of customers, provided the pledgee agrees that securities which it is informed are carried for the account of customers will be physically segregated from any other securities, or (ii) to a lien for a loan made and to be repaid on the same calendar day. For the purpose of this exemption, a loan shall be deemed to be " made against securities carried for the account of customers " if only securities carried for the account of customers are used to obtain or to increase such loan or as substitutes for other securities carried for the account of customers.

(f) *Notice and Certification Requirements.* No person sub-

ject to this rule shall hypothecate any security carried for the account of a customer unless, at or prior to the time of each such hypothecation, he gives written notice to the pledgee that the security pledged is carried for the account of a customer and that such hypothecation does not contravene any provision of this rule, except that in the case of an omnibus account the broker or dealer for whom such account is carried may furnish a signed statement to the person carrying such account that all securities carried therein by such broker or dealer will be securities carried for the account of his customers and that the hypothecation thereof by such broker or dealer will not contravene any provision of this rule. The provisions of this clause shall not apply to any hypothecation of securities under any lien or claim of a pledgee securing a loan made and to be repaid on the same calendar day.

The foregoing rules shall become effective February 17, 1941. [This date was subsequently changed to February 24, 1941.]

In Appendix G is given the text of a release (No. 2690, November 16, 1940), from which is omitted the portion which has been given above.

The attention of the reader is also called to the important amendment passed in 1938 to Section 60 of the National Bankruptcy Act (part of the so-called Chandler Act) on contribution between two or more persons whose securities have been pledged by a B to a C.

Decisions by the Supreme Court of the United States.

That court has, in cases not based on acts occurring in Massachusetts, steadily adhered to the doctrine that the margin customer has both contractual rights *and* property rights, that the broker is not owner but pledgee, and that the broker is subject to all the rules of the common law applicable to pledgees (in the absence of a valid agreement between the broker and the customer to the contrary).

We give only one decision:

Galigher v. Jones.[1] B, a stockbroker in Salt Lake City, was carrying for A some shares of "Challenge," a mining stock. In November, 1878, he made a tortious sale at $1.25 a share. The stock rose and sold in December at $2.00 a share, in January, 1879, at $3.10 and in February at $5.50. The referee, in assessing damages, valued the stock at $3.10, and declined to value it at $5.50 on the ground that, before February, A had had reasonable time after receiving notice (the date of the notice is not given in the report), to replace it by purchase of new stock, if he desired to do so, and he valued the stock at the highest market *price* (note the word) which the stock touched within that reasonable time.

The court held that this was correct. It said: "It has been assumed, in the consideration of the case, that the measure of damages in stock transactions of this kind is the highest intermediate value reached by the stock between the time of the wrongful act complained of and a reasonable time thereafter, to be allowed to the party injured to place himself in the position he would have been in had not his rights been violated. This rule is most frequently exemplified in the wrongful conversion by one person of stocks belonging to another. To allow merely their value at the time of conversion, would, in most cases, afford a very inadequate remedy, and, in the case of a broker, holding the stocks of his principal, it would afford no remedy at all. The effect would be to give to the broker the control of the stock, subject only to nominal damages. The real injury sustained by the principal consists not merely in the assumption of control over the stock, but in the sale of it at an unfavorable time, and for an unfavorable price. Other goods wrongfully converted are generally supposed to have a fixed market value at which they can be replaced at any time; and hence, with regard to them, the ordinary measure of damages is their value at the time of conversion, or, in case of sale and purchase, at the time fixed for their delivery. But the application of this rule to stocks would, as before said, be very inadequate and unjust" (p. 200).

After reviewing the authorities on the measure of damages, it said: "Perhaps more transactions of this kind arise in the State

[1] 129 U. S. 193, 9 Sup. Ct. 335, 32 L. Ed. 658 (1889).

of New York than in all other parts of the country. The rule of highest intermediate value up to the time of trial formerly prevailed in that State, and may be found laid down in *Romaine v. Van Allen,* 26 N. Y. 309, and in *Markham v. Jaudon,* 41 N. Y. 235, and other cases, — although the rigid application of the rule was deprecated by the New York Superior Court in an able opinion by Judge Duer, in *Suydam v. Jenkins,* 3 Sandford (N. Y.) 614. The hardship which arose from estimating the damages by the highest price up to the time of trial, which might be years after the transaction occurred, was often so great, that the Court of Appeals of New York was constrained to introduce a material modification in the form of the rule, and to hold the true and just measure of damages in these cases to be, the highest intermediate value of the stock between *the time of its conversion and a reasonable time after the owner has received notice of it* to enable him to replace the stock. This modification of the rule was very ably enforced in an opinion of the Court of Appeals delivered by Judge Rapallo, in the case of *Baker v. Drake,* 53 N. Y. 211, which was subsequently followed in the same case in 66 N. Y. 518, and in *Gruman v. Smith,* 81 N. Y. 25; *Colt v. Owens,* 90 N. Y. 368; and *Wright v. Bank of Metropolis,* 110 N. Y. 237. (Italics supplied.)

"It would be a herculean task to review all the various and conflicting opinions that have been delivered on this subject. On the whole it seems to us that the New York rule, as finally settled by the Court of Appeals, has the most reasons in its favor, and we adopt it as a correct view of the law" (p. 201).

Comment:

It is true that the question was not presented which arises if the market price between conversion and notice is higher than the market price within a reasonable time after notice. But we submit that under the reasoning of the court (that the real injury is "the sale at an unfavorable time, and for an unfavorable price") the court would in all probability have held that a rebound market price could not properly be ignored.

See our discussion at pp. 269–273 of the injustice to A of allowing B, the involuntary purchaser, to purchase at a panic price, of ignoring completely the *rebound* price if there was a rebound

price, of treating market price on a black day as decisive of *fair* market value on that day, and of making an unauthorized transfer yield precisely the same consequences as an authorized transfer.

Other federal cases which will repay consideration are: *Hennequin v. Clews,*[2] *Logan County Bank v. Townsend,*[3] *Richardson v. Shaw,*[4] *Thomas v. Taggart,*[5] *Gorman v. Littlefield,*[6] *Duel v. Hollins,*[7] *Davis v. Aetna Acceptance Co.,*[8] *Rush v. First National Bank,*[9] *Chew v. Louchheim,*[10] *Hoyt v. Fuller,*[11] *Dibert v. Wernicke,*[12] and *In Re Kardos.*[13]

II. Cases in States other than New York or Massachusetts

All state courts, other than Massachusetts, proceed on the conception that the customer has both contractual and *property* rights.

We give only one decision:

Sproul v. Sloan.[14] B purchased for the account of A 1,500 shares of stock at about $60 a share, and A deposited $30,000 as margin. As this stock was purchased from time to time B mingled it with other securities and pledged to C as collateral for a debt of B's own amounting to more than $1,500,000. This was done without the authority or knowledge of A. Later, B demanded that A should pay his debt, and, on A's refusal, B sold the stock (which had fallen to a low figure). After applying the proceeds on A's debt, B sued A for a deficiency of about $34,000. The trial judge

[2] 111 U. S. 676, 4 Sup. Ct. 576, 28 L. Ed. 565 (1884).
[3] 139 U. S. 67, 78, 11 Sup. Ct. 496, 35 L. Ed. 107 (1891).
[4] 209 U. S. 365, 28 Sup. Ct. 512, 52 L. Ed. 835 (1908).
[5] 209 U. S. 385, 28 Sup. Ct. 519, 52 L. Ed. 845 (1908).
[6] 229 U. S. 19, 33 Sup. Ct. 690, 57 L. Ed. 1047 (1913).
[7] 241 U. S. 523, 36 Sup. Ct. 615, 60 L. Ed. 1143 (1916).
[8] 293 U. S. 328, 332, 55 Sup. Ct. 151, 79 L. Ed. 393 (1934).
[9] 71 Fed. 102 (1895).
[10] 80 Fed. 500 (1897).
[11] 104 Fed. 192 (1900).
[12] 214 Fed. 673, 683 (1914).
[13] 27 F.(2d) 690, 694 (1928).
[14] 241 Pa. 284, 88 Atl. 501, Ann. Cas. 1915B941 (1913).

directed a verdict for A, and the court overruled all assignments of error.

It said that the relations between A and B were those of pledgor and pledgee, and that *the pledge by B to C was a conversion.* "It was contended in the court below that what [B] did was a common usage among brokers, whose business would be seriously interfered with if they were forbidden to repledge securities of their customers. As to this the learned trial judge well said: 'Such a usage can never be shown, if it be in contravention of a well-established rule of law. It is a rule of law in Pennsylvania that the relation between a broker and his customer with respect to stocks purchased upon margin is that of pledgor and pledgee. To permit the broker to use the stock as capital in his own business is to shift the risk of his business upon his customers, a thing never contemplated in the contract. Such a usage, if it exists, is unreasonable: *Malus usus abolendus est*'" (p. 290).

The court also said that in measuring damages the stock was to be valued at the highest price between conversion and trial, and from this amount was to be deducted A's debt to B.

The court then said that B was suing A on a contract; that under that contract B had an obligation to hold the stock for A until he paid the balance of the purchase money; that B had broken his side of the contract, and therefore could not sue upon it.

Comment:

1. Was B's pledge to C a conversion? The answer of the court was "Yes." Our thoughts are in perfect harmony with the court on this, which is the principal point.

2. The tortious pledge to C was both a conversion and a breach of contract. As a breach of contract, the damages for breach of the implied promise not to make a tortious transfer (implied promise No. 1; see our p. 249) were only nominal, without more. It does not seem to us to be sensible to hold that a breach of contract for which only nominal damages are appropriate is such a material breach as to preclude plaintiff from suing on the contract.

3. Then the question becomes whether the conversion should

forfeit the debt, the right *in personam*. Clearly, no. See our pp. 290–291.

4. Did the counsel for A go fast asleep? The stock was worth about $90,000 when purchased, and when tortiously repledged. A had paid $30,000, and therefore owed $60,000. The conversion gave A a cause of action for $90,000 less $60,000. It turned A's debit balance into a credit balance. Therefore the defendant (instead of being content with merely defending) should have interposed a *counterclaim* on which he should have recovered about $30,000.

B was in the hands of a receiver; possibly A thought a judgment for $30,000 was not worth having. (It appears from the report that A had paid in additional margins, so that A might have recovered a judgment in substantial excess of $30,000, but possibly A thought a judgment even for a higher amount than $30,000 was not worth the paper it was written on.)

5. As to the measure of damages which the court said in a dictum to be the correct measure, see the change effected by 1929 P. L. 476 (68 Purdon, Section 481).

Other authorities which a reader may find helpful are collected in 4 R. C. L. p. 267 (Sec. 18), p. 286 (Sec. 33); Ann. Cas. 1915B pp. 894 and 941; 38 A. L. R. 1214, and 48 A. L. R. 797; 29 Michigan Law Review 41 (1930), a valuable collection of Illinois authorities; Cook, Corporations, 6th ed., Sec. 467, note 1.

III. Massachusetts

We give four decisions:

Farrar v. Paine.[15] B held stock as margin against the amount unpaid of the cost of other stock purchased on account of A. B called for further margin, but A failed to meet the call. B sold the stock purchased and afterward the other stock deposited as margin. A sued B for a conversion.

The court, speaking by Holmes, J., said: " This is an action for

[15] 173 Mass. 58, 53 N. E. 146 (1899).

the conversion of five shares of stock. We assume, for the purpose of decision that the conversion is to be taken as established by the finding, and the question raised by the bill of exceptions is whether the judge who tried the case was right in allowing [B] to recoup damages" (p. 58).

The exceptions were overruled. The court considered whether recoupment in contract could be allowed against a claim in tort. "It might be objected that to maintain her claim for the conversion of her property [A] does *not* rely upon her *contract* with the defendants, directly or indirectly, she stands upon her *title* . . . but [B] *had an interest in the property* to the extent of the sum due [B] for which the property was held as *security*, and as against [B, A] to that extent was not entitled to compensation. There are numerous decisions that when pledgees, mortgagees, or persons having a lien *convert* a *pledged* chattel by selling it in an unauthorized way, they are entitled to retain the amount of the *lien*" (p. 59; italics supplied).

Comment:

The doctrine of the court is that B is not owner but pledgee, and that, if B makes a delivery pursuant to an unauthorized sale, A may maintain *conversion* for the value of the pledgor's interest.

One would suppose from this case that Massachusetts law was not contrary to, but in perfect harmony with, the law of New York on the *fundamental* doctrine that B is *not* owner, but only pledgee.

Chase v. Boston.[16] Brokers who had purchased stock for margin customers were assessed by the proper taxing authorities on the stock so purchased, as the *owners* thereof. Was such assessment valid?

The court, speaking by Holmes, C.J., construed the agreed statement of facts "as intended to describe the ordinary relation between broker and customer when stocks are bought upon a margin" (p. 459), and that the brokers claimed to be pledgees, not owners. The court held that the tax was properly assessed to them as owners, saying: "We think that we must assume that in this case, as generally, the brokers were not bound to keep the

[16] 180 Mass. 458, 62 N. E. 1059 (1902).

stock of a certain customer distinct, that they could take a single certificate in their own name for this and similar stock purchased for others, and that they could pledge the whole to a bank for advances made to them, although much in excess of the sum due to them from any one of the persons upon whose orders the stock was bought" (p. 460).

It concluded that, although the profit or loss went to or fell upon the customers, nevertheless the customers did not have property rights but *only* contractual rights. It thought this conclusion was in accord with what has been understood to be the law of Massachusetts ever since the time of Chief Justice Shaw, and said: "The English doctrine seems to be the same as that of this Commonwealth, so that we are not left quite alone in a desert of logic. *Bentinck v. London Joint Stock Bank,* [1893] 2 Ch. 120, 140, 141" (p. 460).

Comment:

1. Not a word was said about *Farrar v. Paine* (p. 379) and yet the same judge wrote both opinions. In the first case the doctrine of the judge was consistent with the thought of the *majority* judges in *Markham v. Jaudon* (p. 260); in this second case, his doctrine is consistent with the doctrine of the *minority* judges in that famous case. He seems to have been wholly unconscious that the doctrines of the two cases (only three years apart) were *diametrically* opposite.

2. The court gave no reason why it "must assume" that it was lawful to repledge for a larger amount. If B was the owner, it was irrelevant even to mention the lawfulness or unlawfulness of a pledge. *Of course* an owner may pledge what he owns.

3. The thought that the broker is the owner is contrary to the conceptions of business men. It lacks business sense.

4. The thought that the broker is the owner, although all hope of gain and all risk of loss is for the customer, is directly contrary to the position which the law usually takes in determining ownership.

5. If a customer has no right *in rem,* and has only a contract right, it follows that if the broker becomes bankrupt, the customer is nothing but an unsecured creditor. He may have paid half the

cost of the stock, and the certificate purchased may be in the possession of the receiver or trustee in bankruptcy, but the customer has no right in the specific *res*. It becomes an asset of the bankrupt estate. The customer has only a right to prove for *breach of contract;* his place is with unsecured creditors.

6. The author has heard it said, and said with enthusiasm, that the expression " not left quite alone in a desert of logic " was characteristic of the picturesqueness, wit and wisdom of Mr. Chief Justice Holmes. Picturesqueness? Yes. Wit? Maybe. Wisdom? No. But it should be conceded that it *was* evidence of a gift of prophecy, for the law on this matter in Massachusetts has ever since had a Sahara of a time.

In *Richardson v. Shaw,*[17] the court held that the broker was pledgee, not owner. Mr. Justice Holmes did not dissent, and said: " If I had been left to decide this case alone I should have adhered to that opinion which, upon authority and conviction, I helped to enforce in another place. I have submitted a memorandum of the reasons that prevailed in my mind to my brethren, and as it has not convinced them I presume that I am wrong. . . . A just deference to the views of my brethren prevents my dissenting from the conclusion reached, although I cannot but feel a lingering doubt " (pp. 384–385).

Furber v. Dane.[18] B (a firm of stockbrokers) bought stocks for the account of Customers No. 1 and No. 2. Customer No. 1 borrowed other stock from X and deposited it with B as margin to protect his account. There was no claim that this was a wrong between X and Customer No. 1. The statements thereafter rendered by B to Customer No. 1 stated: " It is understood and agreed that all securities carried in this account or deposited to secure the same may be carried in [B's] general loans." The court said that the custom of brokers in Boston was " to treat stocks deposited on margin exactly like stocks bought upon margin " (p. 115). B pledged the stock to C, a bona fide pledgee, as part of the collateral for a loan exceeding in amount the debt of

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[17] 209 U. S. 365, 28 Sup. Ct. 512, 52 L. Ed. 835 (1908).

[18] 203 Mass. 108, 89 N. E. 227 (1909).

Customer No. 1 to B. It was conceded that C had independent rights (our p. 22). B failed, and made an assignment for the benefit of creditors. X and Customer No. 1 notified C of the facts, and the question was whether X and Customer No. 1 had a claim to such part of the stock as was not necessary to satisfy C which was superior to the claim of the assignee.

The court held that they had. It said that it was of " some importance " that, at the date of the assignment, Customer No. 1 had (by reason of transactions which are not stated) ceased to be in debt to B. It then said: " Whether *or not* stocks bought on margin are to be treated as the property of the broker rather than of the customer (authorities, including *Chase v. Boston,* 180 Mass. 458, our p. 380), there is no doubt that at any rate the broker has greater rights both as to selling and as to pledging such stocks, when he acts in good faith, than would without special contract belong to an *ordinary pledgee*. . . . [Customer No. 1] was bound by the established customs of trade " (p. 115; italics supplied).

The pledges to C were lawful, but " after all the charges properly to be made against them have been satisfied, [B's] *special property* no longer exists, and they should be returned to the *general owner,* if their identity has been preserved. Neither [B] nor [B's] assignee had the right to say that the other collateral security held by [C] should not be first applied to the payment of [B's debt to C] " (p. 116; italics supplied). Therefore, the stock in the hands of C not needed to satisfy its debt should go, not to the assignee, but to X and Customer No. 1.

There was another transaction with Customer No. 2, and as to him the pledge by B to C was *unlawful*. But C sold the stock pledged and applied the proceeds to its debt (as it lawfully might do). Held, that Customer No. 2 had no rights other than those of an unsecured creditor.

Comment:

1. The opinion is unintelligible, unless Customers 1 and 2 had *property* rights and not merely contract rights. The opinion is apparently based on the *Farrar v. Paine* doctrine (p. 379) rather than the *Chase v. Boston* doctrine (p. 380).

2. It was inappropriate to inquire whether B had more rights than an " ordinary pledgee," unless he was some sort of a pledgee.

3. Here is the thought dear to the old custom-of-the-street Guard that stockbrokers are not " ordinary pledgees," — that the custom of the street hedges them with immunity, that there *is* a financial *imperium* in the common law *imperio*.

4. The court expressly said that stocks deposited as margin were to be treated like stocks bought on margin.

5. As to contribution. (a) Stock unlawfully pledged is given no priority over stock lawfully pledged. (b) The court treats as decisive the survival of the stock in specie; usually a court of equity deals with proceeds of a *res* in the same manner as it deals with the *res*. The rules of the court as to contribution are out of joint with the rules adopted by courts in other jurisdictions, and also with the present provisions of the National Bankruptcy Act.

Crehan v. Megargel.[19] The auditor had found that " the plaintiff understood that in order to finance this transaction [a purchase of stock by a broker, B, for the account of a customer, A] the defendants would be obliged to borrow a substantial amount from some bank. This the defendants did, and the plaintiff assented to the use of such securities as the defendants deposited as collateral security for such loans " (p. 281).

There was a count in tort, and a second count in contract. The court held that a margin customer cannot recover from his broker for a *conversion* if the broker transferred the securities. " In accordance with the long established rule of law in this Commonwealth, the legal title to the stocks carried on margin was in the brokers, as between them and their customer. . . . As the plaintiff did not have the right to immediate possession of the securities alleged to have been converted, he cannot maintain an action of tort for conversion [citing the *Raymond-Syndicate* case, our p. 161] " (p. 282).

But the customer *was* entitled to recover in contract. " The burden rested on [B] to prove that [he] had in [his] possession or control at all times, available for delivery to [A], the stocks

[19] 235 Mass. 279, 126 N. E. 477 (1920).

which they purported to be carrying for him. . . . Instead of carrying this as margin, [B] on or before June 20, 1916, wrongfully disposed of the stock for [his] own benefit without the consent of or ratification by [A] " (p. 283).

Comment:

1. Of course, even if the relation between A, the customer, and B, the broker, was that of pledgor and pledgee, B was entitled to assign to C if he did not purport to assign for more than his, B's, interest. *Jarvis v. Rogers* (our p. 191). It is not stated that he did.

2. But the auditor's finding was immaterial if the relation between A and B was not that of pledgor and pledgee, and the court said that it was not. B was the owner. A had no right *in rem*, but only a right *in personam* against B.

3. That being so, all talk of conversion was inappropriate. An owner does not make himself a converter of somebody's else property by disposing of his own property.

4. The court then says that A could not recover because he did not have the right to immediate possession. But surely such language is only pertinent in case B was not the owner, but was a pledgee, and the court has just said that he was not a pledgee.

5. The court relies on the *Raymond-Syndicate* case (our p. 161). But even if B was pledgee, that case had no application. That case was an A, C case. The case at bar (assuming that B was pledgee, not owner) was an A, B case. And the Massachusetts court had already decided in the *Terminal Refrigerating* case (our p. 163) that in an A, B case, A *could* recover for a conversion of the pledgor's interest even if he did not have the right to immediate possession.

The reader will perhaps now see why we devoted so many pages to *Gordon v. Harper* (pp. 147–160). We were afraid the poison would spread, and the " reasoning " of the court in this case gives occasion for such fear.

6. The report does not state that A tendered and demanded. What were the measure of damages in contract? The court mentions a specific date (June 20, 1916) but the report does not state what happened on that date. If, on June 20, A tendered and de-

manded, and B failed to comply, the damages should have been the fair market value of the stock on that date (less the debt of A to B). But if June 20 was the date when B transferred to some third person and therefore ceased to have stock on hand to meet a tender and demand, the damages in *contract* (remember that the court held that the plaintiff was not allowed to recover in tort, but only in contract) would be merely nominal.

7. The court says that it was B's duty always to have stock on hand to make delivery to A, if there were tender and demand. Apparently it regarded the transfer, the failure to keep stock on hand, as the gist of the wrong. But to say that the damages are the value of the property at the time when B ceased to have sufficient on hand, less the debt, is to give conversion damages, not breach of contract damages.

8. The court *says* the plaintiff may not recover for a conversion, but only for a breach of contract, but then it gives conversion results. The reverse-Cardozo (compare our p. 240).

9. The decision may, we submit, fairly be characterized as a hodge podge.

The reader may find it worth while to look at *Fiske v. Doucette,*[20] *Brown v. Rushton,*[21] *Harris v. Friedman,*[22] *Pizer v. Hunt;*[23] and also at cases where a federal court has sought to apply Massachusetts law, including *In Re Swift,*[24] *In Re Codman,*[25] *In Re Cawley,*[26] and *Leonard v. Hunt.*[27] Sometimes the customer is treated as having only contract rights, sometimes as having property rights. See also 43 Harv. L. Rev. 628 (1930).

The author has had substantial experience with such cases in court. He has sweat blood. He defies any man to say what the Massachusetts law is.

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[20] 206 Mass. 275, 92 N. E. 455 (1910).
[21] 223 Mass. 80, 111 N. E. 884 (1916).
[22] 245 Mass. 479, 139 N. E. 788 (1923).
[23] 253 Mass. 321, 148 N. E. 801 (1925).
[24] 5 Am. Bank. Rep. 232, 239, on appeal 112 Fed. 315 (1901).
[25] 284 Fed. 273 (1922).
[26] 29 F.(2d) 593, 13 Am. Bank. Rep. (N.S.) 221 (1928).
[27] 36 F.(2d) 13 (1929).

The law is in such a sad mess that he sees no hope unless the legislature intervenes. A statute less than a page long could set the matter right, and put the Massachusetts law on a simple, sensible basis in harmony with (1) the conceptions of business men, (2) the decisions in other jurisdictions, and (3) the recent legislation of the Congress of the United States.

Mention is also made of some Canadian and English cases: *Sutton v. Tatham*, 10 Adol. & E. 27, 2 P. & D. 308, 8 L. J. Q. B. 210 (1839); *Pollock v. Stables*, 12 Q. B. 765, 17 L. J. Q. B. 352 (1848); *Mara v. Cox*, 6 O. R. 359 (1884); *Clarkson v. Snider*, 10 O. R. 561 (1885); *Cox v. Sutherland*, 24 C. L. J. N. S. 55, Cass. Dig. 2nd ed. 9 (1887); *Bentinck v. London Joint Stock Bank*, [1893] 2 Ch. 120, 62 L. J. Ch. 358, 68 L. T. (N.S.) 315, 42 W. R. 140, 9 T. L. R. 262, 3 R. 120; *Forget v. Ostingy*, [1895] A. C. 318, P. C.; *Forget v. Baxter*, [1900] A. C. 467, 69 L. J. P. C. 101, 82 L. T. (N.S.) 510, P. C.; *Ames & Co. v. Conmee*, 10 O. L. R. 159, 6 O. W. R. 89 (1905); *Sutherland v. Securities Holding Co.*, 37 S. C. R. 694 (1906); *Conmee v. Securities Holding Co. & Ames & Co.*, 38 S. C. R. 601, 27 C. L. T. 484 (1907); *Trusts and Guarantee Co. v. Brenner*, [1932] O. R. 245, 2 D. L. R. 688, *on appeal* [1933] S. C. R. 656; *Solloway v. Blumberger*, [1933] S. C. R. 163; *Re Heron & Co.*, [1933] 4 D. L. R. 43, O. R. 693; *Rochester v. Solloway Mills*, [1933] 2 D. L. R. 90, O. R. 230, *on appeal* [1934] O. R. 483; *Jarvis v. Moy, Davies, Smith, Vandervell & Co.*, [1936] 1 K. B. 399, 105 L. J. K. B. 309, 154 L. T. (N.S.) 365, C. A.; *Solloway v. McLaughlin*, [1938] A. C. 247, 107 L. J., P. C. 1, [1937] 4 All E. R. 328, 54 T. L. R. 69, P. C.; *Samson v. Frazier, Jelke & Co.*, [1937] 2 K. B. 170, 106 L. J. K. B. 854, 157 L. T. (N.S.) 530.

For the methods on the London Stock Exchange employed by those who desire to speculate, rather than to invest, see "The City," by Ellinger (published in 1940 by P. S. King & Son, Ltd., Orchard House, London S.W.1), pp. 335–8, 341–2, and also note the statement made in the last three lines on p. 154.

Chapter XI

SEPARATION OF DEBT FROM SECURITY

JUDGES have repeatedly said that for a pledgee to separate the debt from the security is a conversion. So far as we know, no judge has ever questioned this principle, — it is accepted as axiomatic.

If B, a stockbroker, repledges the stock of A, a margin customer, to C, a bank, for an amount larger than A's debt to B, B thereby transfers the security to C, but retains the debt. C is not the assignee of A's debt, — C gets a new, independent debt of B to C.

Why is this transaction not a separation of the debt from the security? And why, if it is axiomatic that a separation of the debt from the security *is* a conversion, was it not plain that the tortious repledge in *Wood v. Fisk* (p. 225 *et seq.*) was a conversion? Judge Cardozo did not consider the point and decide against it; he apparently was unconscious that there was such a point to consider. His failure to appreciate this is the basis of one of the seventeen adverse criticisms of his opinion.

We believe that in the bulk of the instances in business life where the debt has been separated from the security, it was a margin customer who owed the debt and owned the security. In such case C, the bank, is safe, and the contest is a two-party contest — between A and B. But other cases have arisen where B, a pledgee, transfers the debt to C, and the security to D. Numerically, these cases are dwarfed in practical importance by margin customer cases involving tortious repledges, but, for intellectual difficulty in scaling, some of these cases tower like the peaks of the Rockies.

We will put six cases which cover most (not all) of the ground:

1. B, the pledgee, transfers second-class security to D, a bona fide purchaser or pledgee, but either keeps the debt himself

(*Donald v. Suckling*, p. 204), or sells it to C and then later reacquires it (*Talty v. Freedman's Trust Co.*, p. 207). Now, since the security was second-class, D did not get what he thought he was getting, — he got only derivative rights. In such case equity consoles him by imposing a trust for his benefit upon the legal title to A's debt which B holds. In other words, as partial redress for the fact that D did not get the right *in rem* which B purported to give him, equity treats D (as between D and B) as the person entitled to receive the payment of the debt. So long as the rights of other persons are not involved, D has all the rights which he would have had if B had assigned the debt and security to him (as he lawfully might; see pp. 191–195). D is the person to whom A should make the tender.

We do not slide over the fact that in *Donald v. Suckling* Mr. Justice Blackburn made some very cautious statements, and left in the air the question whether A should tender to the first pledgee, or to the repledgee, and we express no opinion as to what the English law on that matter is today. But we feel confident that the statements made above are in accord with the thoughts of the Supreme Court of the United States in the *Talty* case, and that the lead of that court on this matter will be followed by most, if not all, states.

This first case is really a very simple case. B is a rascal. D is a good man. Of course, then, in all cases where the only contest is between B and D, D wins.

2. Cases where both debt and security are first-class. For example. A gives a negotiable promissory note to B, secured by coupon bonds. B sells the note to C, a bona fide purchaser, and the bonds to D, another bona fide purchaser (whether the sale to C comes before or after the sale to D makes no difference). Both C and D get what they think they are getting. A must pay C, and, even having done so, cannot embarrass D. He cannot even require D to surrender the bonds if he tenders all that D paid for them; D is now the owner and, if B wants the bonds, he must bargain with D for them.

If D were a bona fide pledgee rather than a bona fide purchaser,

A could get the bonds from D, *but* he would have to tender to D what B owed D, not simply what A owed B.

No adequate attorney, therefore, will allow a client to make a secured promise to pay money unless the promise is in writing, and there is a statement in the writing that the note is secured by so and so. If that precaution is taken, and B, the creditor-pledgee, proves to be a rascal and sells the note to C and the bonds to D, A will, it is true, lose his bonds, *but* he will not have to pay C, for C knew or ought to have known when he bought the debt that B had converted the security or was converting it by the very transaction; and therefore, as he is not a bona fide purchaser, C has only derivative rights, and can collect from A only as much as B could have collected from A.

This does not necessarily mean that C could collect nothing from A in any case. The value of the security *might* have been less than the debt. B's conversion did not forfeit the right *in rem,* and *a fortiori,* did not forfeit the right *in personam.* C, even if he were not a bona fide purchaser, could therefore recover from A the excess of the debt over the amount of conversion damages. But that would be the limit of C's rights against A.

3. Cases where the debt is first-class, but the security is second-class. For example. A gives B a negotiable promissory note for $5,000 and pledges jewels worth $10,000 (and, on the facts, the doctrine of possession, *plus,* does not apply). B sells the note to C, a bona fide purchaser, and the jewels to D, another bona fide purchaser (whether the sale to C comes before or after the sale to D makes no difference).

In such case it is plain that A must pay C. It is also clear law that whatever extinguishes the debt extinguishes the pledge; a pledge interest is, in its nature, terminable upon the payment of the debt. Therefore, from the moment that A paid C, D had nothing but the possession. If A demands the jewels from D, and D absolutely (p. 124) refuses to surrender them, such withholding is neither justifiable nor excusable, and D is a converter, and may, if A elects to sue for money, be required to pay A the fair market value of the bonds at the date of the tortious withholding, without

any deduction whatever. D of course has rights against B, the rascal, but those are likely to be worthless as a practical matter.

A plausible argument may, however, be made for D. It may be urged that A should have written on his note that it was secured, and that if A had done so there could have been no C who was a bona fide purchaser, and, therefore, that D should be, as against A, in as good a position as he would have been in, if there had been no C who was a bona fide purchaser.

We submit that such argument should not prevail. What can be expected from an adequate attorney is one thing; what can be expected from the ordinary prudent man is quite a different thing. There is no justification for a rule that the making of a secured promise to pay money otherwise than by a writing disclosing the security is carelessness. For example. A, the captain of a ship, asked B, a ship chandler, to furnish supplies. B required a negotiable promissory note and security. A deposited his gold sword as security. B sold the note to C, a bona fide purchaser, and the sword to D, another bona fide purchaser. A must of course pay C, but, having done so, he is entitled to the sword from D, for the pledge interest terminated, evaporated, as soon as the debt was paid. A's conduct was not inconsistent with the conduct which may be expected from the " ordinary, prudent man." To be sure, he did not sense a risk which an adequate attorney would have sensed, but attorneys justify their existence by being *better* than the " ordinary prudent man."

4. Cases where the debt is second-class, but the security is first-class. For example. A gives B a promissory note payable to B (as contrasted with a note payable to the order of B) secured by shares of stock indorsed in blank. B sells the note to C, a bona fide purchaser, and the stock to D, another bona fide purchaser (whether the sale to C comes before or after the sale to D makes no difference). As the debt is non-negotiable, C can recover from A only what B could have recovered (which will be nothing, unless the debt exceeds damages for the conversion of the security). A loses his security but he does not *also* have to pay C (unless the debt exceeds conversion damages).

Note, that while A's counterclaim against B for B's conversion is available to A against C in determining how much, if anything, A must pay C, A is *not* allowed, in case the conversion damages *exceed* the debt, to get *affirmative* relief against C for the excess. C succeeded to B's *rights, as reduced* by a pertinent counterclaim, but C did not otherwise succeed to B's liabilities (§ 167 Restatement, Contracts, to the contrary, notwithstanding). So far as we know the only instance in the common law where the purchaser of a right may have cast upon him the burden of an obligation which will more than wipe out the value of the right and plunge the purchaser into the red is a covenant running with the land, and there is no proper analogy to such cases.

5. Cases where both debt and security are second-class, and the B, C transaction is *prior* to the B, D transaction. For example. A gives to B a non-negotiable note, and pledges jewels (the doctrine of possession, *plus,* not applying), and B sells the note to C, a bona fide purchaser, and later sells the jewels to D, another bona fide purchaser.

There are two questions: First, ought A to pay anything? Second, if so, to whom?

A is not under a duty to pay anything to anybody if damages for the conversion (constituted by separation of debt and security) are equal to, or greater than, the debt; and, even if they are smaller than the debt, he need pay only the excess of the debt over the conversion damages.

C's attorney needs his wits. His best chance is to bring a proceeding in equity against A, B and D (getting a preliminary injunction restraining D from transferring the possession), and to ask the court to decree that, as parts of one transaction, A shall pay C, and D shall surrender the jewels to A.

C will have no difficulty in persuading the court that he, C, is the person entitled to the payment of the debt. C purchased the primary, principal thing, and D purchased the secondary, supporting thing. Moreover, C's purchase was prior in point of time. D certainly obtained only an equity in the debt and conceding (contrary to the author's convictions) that C obtained only an

equity, his equity was prior in point of time, and there is no basis whatever for saying that D's equity, although subsequent, is superior.

But A can block C if he wishes to do so. It is for A to call the tune. A may prefer to let the jewels go, rather than pay out cash to C. If he elects to stand on B's conversion, we can see no justification for a court's requiring him to accept back the jewels and pay C.

On the other hand, the security is *usually* worth more than the debt, and it may well be that A will be glad to get back the jewels through paying C.

Conclusion: The court should grant the relief asked by C, if, but only if, A does not object. D has no standing to object.

6. Cases where both debt and security are second-class, and the B, C transaction is *subsequent* to the B, D transaction. Same facts as in case 5, except that B's sale to C comes after B's sale to D.

Everything that was said in case 5 stands, *except* the remark that C will have no difficulty in persuading the court that he, C, and not D, is the person entitled to the payment of the debt. D will make a stiff fight for precedence. The attorney for C will need *all* his wits.

The author is convinced that C should win over D in case 6 as well as in case 5. He reasons that a debt is assignable before default *at law* and not merely in equity, and that C wins by an application of the familiar principle that the bona fide purchaser of a legal title takes that title freed from any cumbering, antedating equity. Note that some of those who reject his reasoning nevertheless reach his result under a "legal power" theory, and that still others who reject his reasoning nevertheless reach his result (or at least are inclined to reach his result) under a superior-although-subsequent-equity theory. The whole of Chapter IV should, at this point, be reread.

The author looks with mixed feelings at his "legal-power" and "superior-although-subsequent-equity" allies. He doubts whether those juristic creatures will stand the rough-and-tumble.

He believes that, if his statements of fact, analyses, and exercises of judgment in Chapter IV are accurate and sound, they afford a basis for a modern law of pledge, on the topic of the separation of debt from security, which will be clear, simple, sensible and harmonious in all its parts.

The author warns the reader against assuming that the statements made in the foregoing six cases may be relied upon as a statement of what the law *is*. They should be accepted as being only a statement of what the author thinks is the law, or, at least, ought to be the law. The decisions are confused and conflicting, and he expressly disclaims ability to give a reliable statement as to what the law *is*. Anyone who steps into the authorities will flounder as in a bog.

The wisest (and also the kindest) thing to do with respect to some decisions on this topic is not even to mention them. But the following cases are valuable: *Dexter v. McClellan,* 116 Ala. 37, 22 S. 461 (1896); *Lunsford v. Marx,* 212 Ala. 144 (1924); *Van Eman v. Stanchfield,* 13 Minn. 75 (1868); *King Cattle Co. v. Joseph,* 158 Minn. 481, 486, 198 N. W. 798, 199 N. W. 437 (1924); *Easton v. Hodges,* 18 Fed. 677 (1883); and *Blundell-Leigh v. Attenborough* [1921] 3 K. B. 235.

In Appendix H (questions and answers) the questions numbered IX and X are pertinent to this chapter. Question No. X is, so far as intellectual difficulty is concerned, *facile princeps* among those ten questions.

Eight appendices, and we have done.

APPENDIX A

Two Further Statements by Coke on Choses in Action
(See Chapter IV)

I. Suppose that A, having a fee, enfeoffed B of a freehold estate (fee simple, fee tail, or life) *on condition,* — the condition might be that B should do something or that he should abstain from doing something. And now suppose that B breaks the condition. Then A would have a right to enter, and by such entry to defeat, terminate, the estate in B of which A had enfeoffed B. *But* there was a common law rule that A could not take advantage of such a condition upon a *freehold* estate "unless he sheweth the proof of the condition in writing." Littleton, Tenures, § 365. Now, suppose that, when A enfeoffed B of a freehold estate upon condition, he delivered to B a deed which contained a statement of the estate granted, *and* of the condition to which that estate was subject, and that he delivered such deed to B, who wanted, for facility of proof, written evidence of the conveyance. Later, the condition was broken, and A entered. B brought action against A, claimed A's entry was unlawful, proved the feoffment from A to B by evidence *other* than that contained in the deed (which the law as it stood before 1677 allowed him to do), and rested. Then A *was* in trouble, for the feoffment was good, although not evidenced by a writing, and yet A could not *defeat* the estate of which he had enfeoffed B unless he could produce in court *written* evidence of the condition, and that written evidence was in the hands of B, and such written evidence was the property of B, not A. The law apparently was that A could not require B to produce the written evidence in court. But if A could induce B voluntarily to bring the written evidence into court, or if A could induce B voluntarily to transfer the property in the document to A so that A could himself bring it into court, then A might take advantage of it, even though it had not been executed by B. "If," said Littleton, § 377, "the feoffee granted the deed to the

feoffer, such grant shall bee good, and then the deed and the propertie thereof belongeth to the feoffer."

Coke commented upon this passage as follows: "Hereby it appeareth that a man may give or grant his deed to another, and such a grant by *paroll* is good. And it is also implied, that if a man hath an obligation, though he cannot grant the thing in action, yet hee may give or grant the deed, *viz.* the parchment and waxe to another, who may cancell and use the same at his pleasure." 232a, 232b.

Now, the probing question is whether Coke was speaking of *broken* obligations, or of *unbroken* obligations. There are three considerations which lead to the conclusion that, pretty surely, he was thinking only of *broken* obligations. (1) His comment was made upon a passage in Littleton where Littleton was discussing *broken* conditions. Coke says that the principle applicable to conditions *also* applies to obligations. It is natural to suppose that he meant only that the law as to *broken* obligations was the same as the law as to *broken* conditions. (2) He speaks of "the thing in action," and he speaks in another place of that as "*nothing else but*" a right to prosecute in court for what *is* due. 285a. (3) Hargrave and Butler, in their learned note to 232a, said that the reason why a "chose in action" could not be assigned was that it was thought that the assignment would be a great encouragement to litigiousness if a man were allowed thus to make over to a stranger his right of going to law. They took it in their stride that Coke was using "thing in action" in the sense in which he defined "action" in 285a.

II. In discussing the rights which a husband acquired by marriage, Coke distinguished between chattels in possession and in action. After he had spoken of chattels in possession, he said: "But if they be in action, as debts by obligation, contract, or otherwise, the husband shall not have them unlesse he and his wife recover them." 351b. Here, we think, it is clear that he did mean to include debts before default within the expression "debts by obligation," and it may be urged that, if he thought that debts before default were not transferable by operation of

law, he must have thought that they were not transferable by voluntary act. But ponder that.

A woman has property. She marries. She was by operation of law deprived of her property to an extent which seems to us today to be shocking. The only question was how far the law was to let this depriving go. If A, the rich bride, married B, the handsome groom, click! All A's coach horses and hunters, her carriages and saddles, her cows, sheep, dogs and hounds, her farm implements, her household furniture, and so forth, belonged absolutely to the bridegroom. A week later, he is killed. Did the widow get back the horses and so forth? If, but only if, her husband had made a will in her favor. Otherwise his legatee or next of kin took. The widow had lost her husband, and was not even consoled by getting once more the ownership of the chattels. No wonder the law did not carry a doctrine which sanctioned depriving her of personal property to the extreme possible limit. It at least made a gesture like a gentleman. We submit that there is no connection whatever between depriving a woman of her property regardless of her will (except as she had willed to marry, regardless of the legal consequences of marriage), and forbidding an unmarried woman to sell, if she so pleases, an unbroken obligation which she ownes. There is a great gulf between taking property from a woman on marriage, regardless of her will, and letting an unmarried woman pass like property to another by voluntary act.

APPENDIX B

Right of the Converter to Surrender the Property in Mitigation of Damages

If after a conversion the converter offers to surrender the property and that offer is accepted, this may of course be shown in mitigation of damages.

But has the converter a right to insist that the proferred surrender shall be accepted? No court, English or American, holds that he has such right.

It is sometimes said that such is the English law. The leading English authority is *Fisher v. Prince*.[1] But in that case the only question discussed was whether, if the defendant offered to surrender the property to the plaintiff, the court had *a discretion* to order the plaintiff to accept it in mitigation of damages. The court held that it had, but also held that, in the exercise of its discretion, it would on the facts of the particular case not order the plaintiff to accept.

In *Rutland & Washington R. R. v. Bank of Middlebury*,[2] the plaintiffs recovered a verdict for a substantial sum. The defendants then offered to restore the bonds in question to the plaintiffs and to pay costs already accrued, and the trial judge ordered that the plaintiff's costs be taxed and that the defendants have leave to bring into court the bonds in question and the amount of the plaintiffs' costs, and that, if the defendants did so, this should be taken into account for the purpose of reducing the damages. The upper court held that the lower court had "the power, as incident to its character as a court of common law jurisdiction and authority to permit, by order, the return of the property sued for in mitigation of damages."

But now suppose that after the conversion the defendant offers

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[1] 3 Burr. 1363 (K. B., 1762).

[2] 32 Vt. 639 (1860).

out of court to surrender the property to the plaintiff and this offer is refused, are the damages recoverable thereby reduced?

In *Carpenter v. Dresser*,[3] a deputy sheriff had made an unlawful attachment. On the next day, he offered to return the goods " uninjured, and in the same condition as when attached." The plaintiff refused to receive them. The trial judge ruled that the damages should be limited to any injury necessarily sustained by the plaintiff by the disturbance of his possession from the date of the attachment to the date of the offered return.

Error. The upper court said that such a rule " would give to the trespasser more power and discretion than courts are accustomed to exercise which order an acceptance of property offered to be returned in mitigation of damages, *after a hearing as to its justice and expediency*. In such case, by the power of the courts, an owner may have to accept a return of his property; but by the power of the party he must accept it, if the defendant's theory prevails.

" It is true, that such a rule would work well in a few peculiar and exceptional cases. The trouble is, that it would operate unjustly in very many and most cases. A dividing line could not be easily established. The rule would have to apply to all cases where the trespass is not wilful, wanton or malicious. This would give the election to a trespasser to decide how an owner shall be compensated for his trespasses. It would have a tendency to stimulate carelessness and unwarranted experiments in attaching property. It would impose unusual and unreasonable risks and responsibilities upon the owner. He may lose his credit, or be broken up in his business, by an improvident trespasser, and still be obliged to accept his goods again. He may, in the meantime, have got other goods, or gone into other business, and not be favorably situated to take the property back. He must at his peril decide correctly whether the trespass was a wanton or malicious act or not. How is he to ascertain that fact? How may he know whether the property will be returned or not? How long shall he be held in suspense by the wrongdoer? How can he al-

[3] 72 Me. 377, 39 Am. Rep. 337 (1881).

ways know whether the property is returned in the same condition as when taken or not? In most cases, his embarrassments would be greater than he could bear. The law does not impose them upon him."[4]

In *Carpenter v. Dresser,* the defendant had unlawfully taken the property. Trespass, or trover, lay at the plaintiff's election, and he elected to bring trespass. If the offer to return did not mitigate the damages in trespass, *a fortiori,* it would not in trover. There are many cases (some trespass, some trover) in accord with *Carpenter v. Dresser.*

McCalla v. Clark (pp. 179–183) is not inconsistent with *Carpenter v. Dresser.*

The following propositions are supported by the weight of authority:

Where a conversion is shown, and a subsequent offer to return is made out of court, the litigation will not be cumbered by directing the jury now to inquire as to what was the state of mind of the defendant, the state of the property when the offer to return was made, and so on. It is not for the defendant to turn the plaintiff's action from trover into replevin.

But where the defendant offers to bring the property into court, the court may, in its *discretion,* order a return to be accepted. Such an order will, however, only be made in exceptional cases. One (but not the only one) of the facts necessary to induce a court to make such an order is that the property in question has in no wise deteriorated in value. In *Rutland & Washington R. R. v. Bank of Middlebury,* the property in question was bonds issued by the plaintiffs, — their own liabilities. The court stressed the fact that, while such bonds might depreciate in value in the hands of third persons, the surrender to the plaintiffs, no matter at what time made, must necessarily reduce their liabilities to the extent of the face value of the bonds. Their value *to the plaintiffs,* therefore, remained constant. The case lay in the mind of the court as one where from the nature of the property it was demon-

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[4] *Id.* at pp. 380–381. (Italics supplied.)

strable that there could have been no deterioration in value to the plaintiffs.

We think that the attitude of most courts would be that while they would not declare that it was not proper in any case to require acceptance of a return, they would in the exercise of a sound discretion rarely, if ever, require acceptance.

APPENDIX C

Trover Lies Only against a Tortfeasor Who Acquired Possession

Trover was originally an action to give redress in a case where the plaintiff had lost the property, the defendant had come into the possession by finding, and had converted it. In the course of time it was extended to all cases where the defendant had come into possession either by finding *or* in any other manner, and had converted the property. But although the necessity of proving, or even alleging, that the defendant came into possession "by finding" passed away, the distinct weight of authority in the trover days was that it continued to be necessary for the plaintiff to allege and prove that the defendant came into possession *in some manner.*

In *Traylor v. Horrall,*[1] A had put his corn into a crib which he had hired for the purpose from X, and which stood on X's land. B and C and some other persons being present where the crib of corn was, B offered the corn for sale, and C bid it off. The court held that A could not maintain trover against either B or C:

". . . In the present cause, it does not appear why the form of a public sale of the corn in question took place. It is not shown that [B], the alleged seller, had seized the property under any process of law, or that at the time of the sale, or at any other time, he had or pretended to have any possession of it whatever. Neither was there any attempt to prove, that [C], the purchaser, ever took possession of the property, or exercised any act of ownership over it."

Similarly, purchasing property at a tax sale, without taking possession,[2] or taking and foreclosing a mortgage, without taking possession,[3] or asserting ownership of property, without taking

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[1] 4 Blackf. 317 (Ind. 1837). Accord, *The Lancashire Waggon Co. v. Fitzhugh,* 6 Hurlst. & N. 502 (Exch., 1861).

[2] *Forth v. Pursley,* 82 Ill. 152 (1876).

[3] *Burnside v. Twitchell,* 43 N. H. 390 (1861).

possession,[4] or purporting to make a levy, without taking possession,[5] is not a conversion.

Similarly, if the goods of A came into the possession of B, and C negotiated a sale from B to D, that, without more, would not make C a converter. A man comes into an auctioneer's yard holding a horse by the bridle, and says: " I want to sell my horse; if you will find a purchaser I will pay commission." And the auctioneer says: " Here is a man who wants to sell a horse; will anyone buy him? " If he then and there finds him a purchaser, and the seller himself hands over the horse, the auctioneer is not a converter.[6]

Similarly, in a case where a tenant had borrowed money from the plaintiff on the security of some household furniture, and on the failure of the tenant to pay had lawfully taken possession. The landlord who wished to distrain the next day on the goods for rent unpaid had forbidden the plaintiff to remove the goods and had employed a policeman to prevent the removal, but had not taken possession of the goods. The landlord was held not to be liable in trover.[7]

There are, however, other authorities which should be mentioned.

In *Bristol v. Burt*,[8] the defendant, an officer of the law, unlawfully refused to grant clearances of certain goods. He did not take possession. The plaintiff brought trover, and was allowed to recover. But the damages awarded were not the full value of the goods but only the difference between the market value at the time clearance was unlawfully refused and at the time when clearance was granted. The plaintiff was no doubt entitled to such damages in an action on the case, and this decision is out of joint with the weight of authority at that time only because the court

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[4] *Huddleston's Adm'r v. Currin*, 4 Humph. 237 (Tenn., 1843).

[5] *Herron v. Hughes*, 25 Cal. 555 (1864).

[6] By Bramwell, J., in the course of his opinion in *Cochrane v. Rymill*, 40 L. T. (N.S.) 744, 746 (C. A. 1879), approved by Collins, J., in *Consolidated Co. v. Curtis*, [1892] 1 Q. B. 495, 500.

[7] *England v. Cowley*, L. R. 8 Exch. 126 (1873). Accord, *Boobier v. Boobier*, 39 Me. 406, 409 (1855).

[8] 7 Johns. 254, 5 Am. Dec. 264 (N. Y., 1810).

did not lay stress on the form of action. It was in advance of the times in not doing so. The case is not an authority that a defendant who has never come into possession may be required to pay the full value of the property.

In *Vilas v. Mason*,[9] a landlord unlawfully forbade a tenant of a hotel, ten days before the lease expired, to remove articles which belonged to the tenant. The tenant thereafter surrendered up the possession of the hotel and left the articles in it. The court held that the tenant might, on surrendering the premises, leave the articles and treat the acts of the landlord as a conversion. This case is not inconsistent with a rule that a defendant is not a converter unless he came into the possession of the property. The landlord did come into possession at the expiration of the lease. The court did not decide that if the landlord had forbidden, and threatened to enjoin, the removal he would without more have become a converter.

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[9] 25 Wis. 310 (1870). See also *Ramsby v. Beezley*, 11 Ore. 49, 8 Pac. 288 (1883); *Mead v. Thompson*, 78 Ill. 62 (1875).

APPENDIX D

Species 1, 4 and 5 of Conversions

Species (1); *Taking by Force or Fraud.*

It will rarely happen that a wrongful taking by a defendant will not be a major tort. Any taking which involves a denial of the plaintiff's title is a conversion, and there will be such denial not only where the defendant claims the title is in himself, but also where he claims the title is in some third person.

Let us now assume that there has been a wrongful taking by the defendant which was more than a trifling wrong. Will the defendant be excused because he in good faith believed that the taking was lawful, and such belief was not due to carelessness on his part? The law is clear that he will not be excused. If, for example, an officer of the law holding a writ commanding him to attach or levy execution upon the goods of X, takes the goods of A, believing and reasonably believing that they are the goods of X, he is a converter. Where the conversion is a wrongful taking, the defendant will not be allowed to go to the jury on the question whether he acted in good faith and with due care; he must abstain from such a wrong, and not merely have some perfectly good reason why he did the wrong.

If B by fraud induces A to transfer the possession of A's goods to him, he is a converter. And if B by fraud induces A to transfer to him not only the possession but also the title, the fact that the title passed will protect C, a bona fide purchaser from B, but B himself is a converter. Securing by fraud possession *and* title is clearly not less a wrong than securing by fraud the possession alone.[1]

Species (4); *Altering the Condition of the Property.*

If A's property gets into the possession of B who without authority sells it to C, a bona fide purchaser, and C takes the prop-

[1] *Thurston v. Blanchard,* 22 Pick. 18, 33 Am. Dec. 700 (Mass. 1839).

erty into his possession pursuant to his purchase, C is in most jurisdictions a converter, without more, and therefore it is immaterial to inquire whether he later altered the condition. In New York and a few other jurisdictions, however, the bona fide purchaser is not a converter, without more. The "more" is not necessarily a refusal to deliver on demand; the "more" may be disposing of the property to another (p. 137); possibly it may be a serious alteration of the condition of the chattel, but upon this we have found no helpful authorities.

Suppose that B, a rascal, is in possession of A's property, and he brings it to C, who believes and reasonably believes that B is the owner, and employs him to alter the condition, and C does so. Is C a converter? If A's furs are stolen by B, and B takes them to C who, at B's orders and in good faith, cuts them up and makes them into a new garment, is C a converter? If A's jewels are stolen by B, and B takes them to C who, at B's orders and in good faith, recuts and resets them, is C a converter?

In *McPheters v. Page*,[2] the plaintiffs lawfully killed some deer, and the deer were unlawfully seized by officers of the law. These officers took them to the defendant's meat market. He knew that the officers had acquired possession by seizure. He skinned the carcass and saddles, cut them up into steaks and roasts, let one of the officers have paper to do the pieces up to distribute to his friends, and sent a few of the orders out with his own team. He used none of the meat himself, and sold none. The court held that the defendant was a converter, though he might have been ignorant of the want of title in the officers.

This case might be disposed of on the ground that the defendant, since he knew the property was seized, was put upon inquiry whether that seizure was lawful. But the reasoning of the court is independent of that consideration; he had exercised a dominion over the property destructive of it, and the fact that he was the servant of others who were themselves wrongdoers would not save him.

In *Philpott v. Kelley*,[3] a pipe of wine belonging to A came from

[2] 83 Me. 234, 22 Atl. 101, 23 Am. St. Rep. 772 (1891).

[3] 3 Ad. & E. 106, 114 (1835).

B to C who bottled it. The court said it was not a conversion "if done by the direction of the party depositing, or if done for the best, with a view to preservation."

Mr. Justice Blackburn, in the course of his opinion in *Hollins v. Fowler,*[4] considered the case where A's oats get into the possession of B, who without A's authority brings them to C to be made oatmeal. "Suppose," he said, "the miller had honestly ground the oats and delivered the meal to the person who brought the oats to him before he even heard of the true owner. How would the law be then? . . . If ever such a question comes before me, I will endeavor to answer it."

Mr. Justice Blackburn had an instinct for avoiding the discussion of questions not likely to arise. Search the books, and one will find very little indeed upon such cases. Perhaps the wise course is to follow the example of Mr. Justice Blackburn, and not attempt to answer such questions until they do arise.

One other case calls for a word. In *Simmons v. Lillystone,*[5] certain pieces of timber belonging to the plaintiff were on the defendant's land, embedded in the soil. The defendant directed his workmen to dig a saw-pit in his land, and in so doing they cut through the timber, leaving the pieces there, and part of them were afterwards carried away by the tide. This was held to be no conversion. The whole thing had not been destroyed. If there was a wrong, it was not so serious a wrong as to make it fitting that the defendant should be required to pay the full value.

Species (5); *Using the Property.*

Most of the cases on misuser are bailment cases where A has bailed to B, B has a right to use for some purpose, but does use for some other purpose.

The law a century or so ago was severe. The instant that the bailee consciously stepped over the bounds, he was a converter. If one hired a horse to be driven to one place, and voluntarily drove him to another, it was a conversion.[6]

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4 L. R. 7 H. L. 757, 768.

5 8 Exch. 431 (1853).

6 *Wheelock v. Wheelwright,* 5 Mass. 104 (1809).

Possibly, there are some courts that would still follow that rule of law, but most, if not all, courts have come to see that it is not fitting in the bulk of cases where there has been some misuser by the bailee. It is regrettable that, in declining to follow the old precedents, some judges still paid lip-service to the old rule, and said that stepping out of bounds was a "technical conversion" (p. 233).

There may still be a misuser by a bailee so serious as to amount to a conversion. In *Bryant v. Wardell*,[7] certain theatrical accessories had been bailed to the defendants to be used in a certain exhibition. They were taken to pieces, reconstructed, and used at a different exhibition. The court held that the bailment was terminated, and trover would lie. On similar facts, most, if not all, modern courts would reach a similar result. The subsidiary facts being found by the trier of the fact, it will be for the court to determine whether the misuser is so serious as to amount to a conversion.

Rarely today will the misuser by a bailee amount to a conversion. Suppose an automobile has been hired to go from X to Y. The bailee pushes on to Z, returns to Y, and on the way back from Y to X the automobile is damaged. Most courts would hold that the probing question was: Did the extra drive cause or materially contribute to the damage? [8]

Suppose the loss or damage occurs during the deviation, — while the car is on the road from Y to Z, or Z to Y. Even so, some courts would hold that there was then only a prima facie case that the damage was caused by the deviation, and that the defendant was at liberty to bear the burden of proving that it was not so caused. See *Harvey v. Epes*.[9] But more courts would hold that, during the deviation, the bailee is in the position of an insurer, so that it will ordinarily be unimportant to inquire how the loss or damage occurred. See *Hooks v. Smith*.[10] Both the rule of *Harvey v. Epes* and the rule in *Hooks v. Smith* supply

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[7] 2 Exch. 479 (1848).

[8] *Farkas v. Powell*, 86 Ga. 800, 13 S. E. 200, 12 L. R. A. 397 (1891).

[9] 12 Gratt. 153 (Va., 1855).

[10] 18 Ala. 338 (1850).

lesser deterrents against such unauthorized acts than is supplied by treating the unauthorized acts as conversions, and whether the one rule or the other is the more fitting is not a question in the law of conversion.

Where the plaintiff's property comes into the possession of the defendant, and the defendant has no authority to use it for any purpose, the old law was that any user was a conversion.

But this is no longer law. In *Frome v. Dennis*,[11] the plaintiff, A, left his plow on the farm of B, with B's consent, until A should come and take it away. The farm passed into the possession of C, the plow being still there. D, a neighboring farmer, borrowed the plow from C supposing it belonged to C. He used it to plow a field and in three or four days returned it to C, still supposing it to be his property. Later A demanded the plow from him. The court held that a refusal to deliver what the defendant had no ability to deliver was not a conversion (our p. 122), and that his temporary user under these circumstances was not a conversion. "His acts may have constituted a trespass, but not a conversion."

Suppose the defendant was not authorized to make any use of the property, and did use it, conscious that he was doing what he had no business to do. Under the old law he was a converter; and he still would be, unless the user was trivial.

But if it were trivial? A's car is before his door. Some lad cannot resist the temptation to jump in and drive it around the block, but without any intent to do more. May A require the lad's father, who is responsible for his torts, to pay A the full value of the car? Possibly, but we incline against it.

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[11] 45 N. J. L. 515 (1883).

APPENDIX E

Hollins v. Fowler, L. R. 7 H. L. 757 (1875)

Fowler & Co. instructed their broker to sell for them some bales of cotton. A rascal, Bayley, a cotton broker in Liverpool, proposed to buy. The broker of Fowler & Co. refused to sell unless the name of a responsible person was given as the purchaser. The name of one Seddon was given, and, the inquiries as to Seddon being quite satisfactory, the broker of Fowler & Co. sent to them notice that they had sold the bales to Thomas Seddon, per H. K. Bayley, and delivered the bales to Bayley. The intent being to sell to Seddon, not Bayley, the title did not pass to Bayley, — he by his fraud secured the possession, but not the title.

Thereafter Bayley offered the cotton to Hollins & Co., cotton brokers, who consented to purchase. They had on that morning received a message from Micholls & Co., cotton spinners at Stockport (for whom they were in the habit of purchasing cotton), stating that on that day Mr. Micholls would be in Liverpool to purchase cotton through them, and they had bought the cotton from Bayley believing it to be of the sort which Micholls & Co. would require. On examining the cotton, Mr. Micholls agreed to take it. Hollins & Co. were in the habit of thus buying cotton in the belief that their customers would take it; if the particular customer for whom it was intended did not take it, they would dispose of it to some other customer.

Later, Hollins & Co. paid Bayley, took delivery, and forwarded to Micholls & Co. Fowler & Co. failed to get their money, the fraud of Bayley was discovered, and the members of Fowler & Co. brought an action of trover against the members of Hollins & Co.

At the trial, two questions were left to the jury: first, whether the thirteen bales in question had been bought by the defendants as agents in the course of their business as brokers; and, secondly, whether they dealt with the goods as agents for their principals. Both questions were answered in the affirmative.

There was prolonged litigation, and the case was not decided in the House of Lords until five years after the trial. The judges were summoned, and Mr. Justice Blackburn, Mr. Justice Mellor, Mr. Justice Brett, Mr. Baron Cleasby, Mr. Justice Grove and Mr. Justice Amphlett attended, and gave opinions. The members of the House of Lords who gave opinions were Lord Chelmsford, who gave the leading opinion, followed by Lord Cairns, Lord Hatherly, and Lord O'Hagan.

This case is commonly supposed to be the leading authority on the liability of a broker for the *purchaser,* but most of the judges concerned themselves chiefly, or exclusively, with the proper interpretation of the findings of a jury which were against the weight of the evidence, even where a motion to set the findings aside on that ground had been denied.

It would seem to be plain enough that Hollins & Co. purchased from Bayley on their own account. True, they expected that Micholls & Co. would take the cotton. But they had no authority from Micholls & Co. to buy it. Hollins & Co. took a risk, and no doubt a good business risk, in purchasing. They wished to be in a position quickly to meet the requirements of a valued customer. But it was entirely for Micholls & Co. to decide whether they wanted this particular cotton; if they decided against it, Hollins & Co. would have accepted their decision without a murmur, and would have disposed of the cotton elsewhere. They purchased, and were ready to have the benefit of their purchase taken by a customer and to charge the customer only a broker's fee if they had forecast his wishes aright; but when they purchased, they purchased without a principal.

Therefore the findings of the jury were against the weight of the evidence, and should have been set aside on that ground. The difficulty was that a motion had been made to set them aside on that ground, and such motion had been denied. Were the judges, in spite of that, to treat these findings as an insurmountable difficulty to seeing what the fact was? Seven of the ten judges surmounted the difficulty (all but Mr. Justice Blackburn, Mr. Justice Brett, and Mr. Justice Amphlett).

That difficulty surmounted, the case was plain. Under the Eng-

lish law, a bona fide purchaser of the goods of the plaintiff who takes possession of the goods pursuant to his purchase is a converter, without more. That had been settled long before *Hollins v. Fowler,* and seven out of the eight judges who gave opinions holding the defendants liable as converters based this result primarily, or exclusively, upon this ground.

But Mr. Justice Blackburn, Mr. Justice Brett and Mr. Justice Amphlett felt bound by the jury's findings to treat the defendants as brokers, and not as purchasers on their own account. Were the defendants nevertheless liable? On that Mr. Justice Blackburn said "Yes," and Mr. Justice Brett (with whom Mr. Justice Amphlett concurred) said "No."

If the opinions of the six judges who gave advisory opinions are examined, it will be found that Mr. Justice Blackburn was not seconded by anyone. Mr. Baron Cleasby kept quiet on what may be called the Blackburn-Brett controversy. Mr. Justice Amphlett agreed with Mr. Justice Brett; and Mr. Justice Mellor and Mr. Justice Grove intimated that they would have agreed with him, if they had reached that question.

Turning to the opinions of those whose function it was, not to advise but to decide, we find all four judges treating the defendants as purchasers on their own account, and not merely as brokers for purchasers.

But Mr. Justice Blackburn fares better here. Lord Chelmsford moved the judgment, his opinion was the leading opinion, in which his noble and learned friends concurred, and, although he placed his decision primarily on the ground that the defendants were purchasers on their own account, he clearly approved of Mr. Justice Blackburn's thought that, even if they were only brokers, they were liable as converters. "Any person who, however innocently, obtains possession of the goods of a person who has been fraudulently deprived of them, and disposes of them whether for his own benefit *or that of any other person* is guilty of a conversion." (Italics supplied.)

It is of course possible to distinguish the ordinary auctioneer case from *Hollins v. Fowler.* A's goods get into the possession of B, a rascal. B employs C, the bona fide auctioneer, to turn the

goods into money; C negotiates a sale to D and delivers the possession; C converts (p. 127). But change the facts a little. B comes to C, a bona fide broker, who has authority from D to purchase such goods. B seeks to turn his goods into money by making a sale to D, through C. C does make the purchase for D from B, receives the possession and passes it on to D. Is there enough of a difference here to call for a difference of result?

We think, at least on such facts as were presented in *Hollins v. Fowler*, that there is not. Hollins & Co. did not do a specific act at the direction of Micholls & Co.; on the contrary it was their business to select the person from whom the purchase was to be made. They did so, and bought from one who had no authority to sell. Mr. Justice Blackburn's opinion hampers rascals from profiting by their rascality, and this is one of the great heads of the law of conversion. It requires brokers at their peril to buy from the right person, and not merely to have some perfectly good reason for having bought from the wrong person.

Before leaving *Hollins v. Fowler*, a word should be said about *Stephens v. Elwall*,[1] a case cited with approval by both Mr. Justice Blackburn and Lord Chelmsford. Bankrupts, after their bankruptcy, sold the goods to one Deane, to be paid for by bills on Heathcote, who had a house of trade in London, and for whom Deane bought the goods. Heathcote was in America, and the defendant was his clerk, and conducted the business of the house. Deane communicated to the defendant information of the purchase on the day it was made and the goods were afterwards delivered to the defendant, and he disposed of them by sending them to America to Heathcote. The assignees for the benefit of the creditors of the bankrupts were allowed to maintain trover against the defendant and Lord Ellenborough used language often quoted: "A person is guilty of a conversion who intermeddles with my property and disposes of it, and it is no answer that he acted under authority from another, who had himself no authority to dispose of it."[2]

Mr. Justice Blackburn said he could see no possible distinction

[1] 4 M. & S. 259 (K. B., 1815).

[2] *Id.* at p. 261.

between that case and *Hollins v. Fowler*. Deane had a "*de facto* property" and Elwall assisted in transferring the goods from Deane to the defendant's master in America, with intent to transfer Deane's *de facto* property to the defendant's master. Bayley had a *de facto* property which Hollins & Co., by their dealing with the possession, transferred to Micholls.

Stephens v. Elwall gives us pause. We think that Lord Ellenborough's language, unrestrained, carries the law of conversion too far.

The facts in *Stephens v. Elwall* admit of two possible interpretations. One was that Deane was a buyer in the provinces, that Elwall was, as the London representative of Heathcote, in charge of the business during Heathcote's absence, that when Deane had bought and sent the goods to London he had done all that he had authority to do; that it was then for Elwall to take the helm and decide what should be done with the goods, and that, pursuant to a general discretion vested in him by Heathcote, he decided that the best thing to do with the goods was to send them to America. On that interpretation of the facts (which seems to us the more likely interpretation) Elwall would have taken the initiative in sending the goods three thousand miles away. This was certainly a serious wrong to the plaintiffs, the goods had been "disposed of" with a vengeance, and the sole fact that Elwall was acting for another ought not to shield him.

But there is another possible interpretation of the facts. Deane *may* have been Elwall's superior; it may have been Deane, not Elwall, who had the authority to make, and who did make, the decision that the goods should be shipped to America, and Elwall may simply have attended to the details of making the shipment which Deane had ordered should be made.

In a case on such facts, we submit that the clerk ought to be excused. It is not reasonable to subject a clerk who has carried out such an order, believing and reasonably believing that he was doing a lawful act, to the liability of a converter. Nor is it for the good of the community that servants or agents should be made to doubt whether they may safely obey their masters or principals. We quote from a case even older than *Stephens v. Elwall:* "The

action will not lie against the servant; for it being in obedience to the master's command, though he had no title, yet he shall be excused. And this rule Justice Scroggs said would extend to all cases where the master's command was not to do an apparent wrong; for if the master's case depended upon a title, be it true or not, it is enough to excuse the servant; for otherwise it would be a mischievous thing, if the servant upon all occasions must be satisfied with his master's title and right before he obeys his command."[3] See our pp. 125–127.

In *Leuthold v. Fairchild*, the Minnesota court said: "We hold the rule of law to be that an agent or servant who, acting solely for his principal or master, *and by his direction*, and without knowing of any wrong, or being guilty of gross negligence in not knowing of it, disposes of, or assists the master in disposing of, property which the latter has no right to dispose of, is not thereby rendered liable for the conversion of the property."[4]

One of our fundamental thoughts is that not all tortious intermeddlings are conversions. The court should inquire in the first place whether the wrong is a serious wrong, — the wrong may be so slight that imposing a liability to pay the full value of the property is not fitting. *Fouldes v. Willoughby* stated at p. 113 will serve as an illustration of a tortious intermeddling which is not sufficiently serious to amount to a conversion. *And,* even if the wrong is a serious wrong, the court should inquire, in the second place, if the circumstances are such that the defendant should be excused.

Hollins v. Fowler is famous, in large part, owing to a discussion by Mr. Justice Blackburn of the question whether *all* tortious intermeddlings were conversions. Possibly Lord Ellenborough thought they were, but it is noteworthy that Mr. Justice Blackburn thought otherwise. He thought that some acts of storage, and some acts of transportation, although unauthorized, were not conversions, and it is safe to say that all modern courts will go as far as he was willing to go in limiting the scope of conversion.

Take acts of storage. A's goods get into the possession of B,

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[3] *Mires v. Solebay*, 2 Mod. 242, 244 (C. P., 1676, our p. 126).

[4] 35 Minn. 99, 111, 27 N. W. 503, 28 N. W. 218 (1886; italics supplied).

who has no authority to deal with them. B takes them to C, a warehouseman, who stores them. Later on, before A asserts himself, C returns them to B. Mr. Justice Blackburn said that C would not be a converter.[5]

Of course this does not carry us far. C has not disposed of the goods, — he has not set them afloat on a sea of persons, strangers to A. C has simply restored the *status quo ante*.[6]

But change the facts. C, instead of restoring the goods to B, delivers them, at B's order, to D. Here C has disposed of the goods. Does that make him a converter? Mr. Justice Blackburn did not expressly give any opinion on this point, although his approval of *Greenway v. Fisher* (*infra*) would tend to show that he would not have held C to be a converter.

There is a case in this country which may be noted. In *Hudmon Bros. v. DuBose*,[7] A had a mortgage upon certain cotton. B, without his authority, stored it with C, and C later, at B's order, delivered it to D. The court held that C was a converter. The mortgage had been registered, and the court held that this gave constructive notice of it to C. This case is therefore not decisive in a situation where C had no such notice.

Suppose C has no actual or constructive notice that he is participating in a wrong. Is the law that he is not a converter if he restores to B, but is a converter if he delivers to D, at B's order? No one can feel sure as to the answer.[8]

Take acts of transportation. In *Greenway v. Fisher*[9] A entrusted certain goods to B for sale. B pledged these to D (the transaction apparently occurred before there was a Factor's Act), and B employed C, a packer, to ship the goods to D, who did so. Was C a converter? The court held not. Abbott, C.J., said that here was a public employment and that a carrier, while he is a mere conduit pipe in the ordinary course of trade, is not liable as a converter.

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[5] L. R. 7 H. L., 757, 767.

[6] See *Nelson v. Iverson*, 17 Ala. 216 (1850); *Hill v. Hayes*, 38 Conn. 532 (1871); *Loring v. Mulcahy*, 3 All. 575 (Mass., 1862).

[7] 85 Ala. 446, 5 So. 162, 2 L. R. A. 475 (1888).

[8] *Cf. Parker v. Lombard*, 100 Mass. 405 (1868), with *Varney v. Curtis*, 213 Mass. 309, 315, 100 N. E. 650, 653, L. R. A. 1916A 629, Ann. Cas. 1914A 340 (1913).

[9] 1 Carr. & P. 190 (N. P., 1824).

Mr. Justice Blackburn approved this decision. He thought the case had not been put upon the right ground since a packer was not like a carrier bound to receive all goods brought to him, but that the result was right since B had done no more than assist in the change of custody. The case is meagrely reported, and, possibly, our statement that B employed C to ship the goods to D is not justified, but this interpretation of the facts accords with probability. If this interpretation of the facts is justified, then the approval of the decision by Mr. Justice Blackburn is noteworthy. For here is an act of disposition which is not a conversion. The goods come from B to C and are not to be shipped to B at another place, but are to be shipped and delivered to a third person, D. And if the defendant had been, not a packer but a common carrier, then we should expect Mr. Justice Blackburn to hold that, *a fortiori,* the common carrier who took from B, and at his order shipped and delivered to D, was not a converter.

But we do not feel at all confident that we have fathomed Mr. Justice Blackburn's mind on this matter.

He put a hypothetical case.[10] Suppose Hollins, after getting the delivery order for the cotton from Bayley, had sent it to Micholls, who had handed it to the railway company, requesting them by means of it to procure the goods from Bayley's warehouse in Liverpool, and carry them to Stockport, and the railway company had done so, would the railway company have been guilty of a conversion?

He answers this in the negative, *provided* that the railway company did not know it was doing more than " to transfer the custody of goods from a warehouse at Liverpool to one at Stockport." But, he continued, " if the Railway Company, in the case supposed, could have been fixed with knowledge that more was done than merely changing the custody, and knew that the company's servants were transferring the property from one who had it in fact to another who was going to use it up," then otherwise. " It would, however, be very difficult, if not impossible, to fix a railway company with such knowledge."

Why would that be difficult? Micholls & Co. are running a factory for the spinning of yarn in Scotland. In the course of

[10] L. R. 7 H. L. 757, 767.

their business they necessarily buy cotton from time to time in Liverpool, and have it brought to their factory to be spun into yarn. The servants of the railway company can scarcely escape knowledge that that is the usual course of business. Suppose Micholls hands the delivery order to the railway superintendent in Stockport and says: "We have just bought this cotton. We urgently need it to spin into yarn. Rush the shipment." The railway company is, at least in such a case, fixed with knowledge that it will be transferring the property from one who had it in fact to another who was going to use it up. And yet it does not seem sensible to say that therefore the railway company is a converter when it transports the cotton.

There is a case in this country which may be noted. In *Burditt v. Hunt,*[11] A's goods were in the possession of B who without authority sold them to D. D directed C his servant to go to B's shop, get the goods, and bring them to D's shop, and he did so. C was ignorant of the terms of the contract of sale and of any circumstances making the sale invalid, but the probable interpretation of the facts is that he did know that D had bought from B. He was held not to be a converter. The court also said that the same principle would be applied for the protection of common carriers.

In the present state of the authorities it is impossible to say whether C, who stores or transports for B, and who is certainly not a converter if he returns to B, is nevertheless a converter if he delivers to D, at B's orders.

We submit that if A's goods get into the possession of B, and B, without A's authority, directs C to store or transport them and deliver them either back to B, *or* to some third person, D, and C does this, believing and reasonably believing that this is a lawful act, and does it before A has asserted himself, C should not be held liable as a converter.

It is one thing to require a cotton broker to determine at his peril whether he is buying from a person authorized to sell. It is a very different thing to require a person employed only to store

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[11] 25 Me. 419 (1845).

or transport to determine at his peril whether the goods have been properly brought to him.

There is one further species of tortious disposition which, although not mentioned by Mr. Justice Blackburn in *Hollins v. Fowler,* may profitably be here considered.

A's property gets into the possession of B. B without authority pledges the property to C. Is C a converter without more, — simply because he took possession and claimed a pledge interest in the property? Lord Ellenborough thought he was. But the English law was settled otherwise in *Spackman v. Foster,*[12] and the weight of authority in this country is with *Spackman v. Foster.* Therefore, if C (in good faith) takes on pledge from B, and later returns to B, C is not a converter,[13] any more than he would have been if he had stored or transported it for B, and returned it to B. There is here no act of disposition.

But suppose C, at B's order, transfers the pledged property to D. Here there is an act of disposition. Is C a converter?

In *Leuthold v. Fairchild,*[14] Young operated a grain warehouse at Kasson, and was engaged in the business of storing wheat, and issuing receipts therefor. He was also engaged in buying wheat on his own account, which was mingled with the wheat of his customers, and also in buying in from time to time outstanding receipts. It was his duty to keep on hand enough wheat to meet all outstanding receipts, and a delivery of any wheat depleting his stock below the total amount named in the outstanding receipts was clearly a conversion by him.

He did make such a sale to a purchaser in Chicago. The wheat was delivered to a railroad company which issued a bill of lading therefor. He drew on the purchaser, and induced a bank to discount the draft, with the bill of lading as security. The bank forwarded the draft and the bill of lading to its correspondent who, upon receipt of the amount of the draft from the purchaser, delivered the bill of lading to the purchaser who was thereby enabled to get the wheat. Was the bank a converter?

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12 L. R. 11 Q. B. D. 99.

13 *Leonard v. Tidd,* 3 Metc. 6 (Mass., 1841).

14 35 Minn. 99, 27 N. W. 503, 28 N. W. 218 (1886)

To restate: A's grain gets into the possession of B. B pledges it to C, and C, upon being paid, delivered the grain to D. Here the pledgee, to get the payment of the amount due to it, did not return the property to B but passed it on to D at B's order. There was an act of disposition.

The court, speaking by Mitchell, J., held B not liable, saying:

". . . If banks and bankers cannot take security through the bills of lading upon grain shipped, for the advances made by them to the shipper, not meddling with the grain itself, without becoming liable as for the conversion of the grain in case the title of the shipper fails, the risk attending such advances will be so great as will tend to deter parties from making them; and we apprehend that thereby the business of shipping grain to market will be seriously interfered with." [15]

Should a bank be required at its peril to ascertain the facts as to the amounts of the outstanding receipts and of the grain on store? The court thought not, — this would result in too serious an interference with the business of the community. The wrong is a serious one. But, for the sake of the community, it must be excused. (Of course the court was only speaking of a bank which was acting in good faith, as appears from other parts of the opinion not here quoted.)

Compare this case, however, with *Varney v. Curtis*.[16] A's non-negotiable bonds got into the possession of B, who forged indorsements, opened an account with C, a stockbroker, for the purchase and sale of stocks and bonds on margin, and delivered the bonds to C as security for his account. Later, B directed C to transfer the bonds to D, another stockbroker, on receiving from D the amount due him. C knew that D intended to step into his, C's, place, and to hold the bonds as collateral.

The court held that C was a converter. Here was an act of disposition. The court sharply distinguished between an act by which C returned the pledged property to B, and an act by which C passed it on to D, at B's order.

Although *Leuthold v. Fairchild* and *Varney v. Curtis* have many

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[15] *Id.* at pp. 107–08.

[16] 213 Mass. 309, 100 N. E. 650, L. R. A. 1916A 629, Ann. Cas. 1914A 340 (1913).

points of similarity, it is possible to distinguish them. If a customer, B, appears with an instrument purporting to be indorsed by A, C, the broker, can ascertain whether this is a forgery or not by inquiry from A; whereas a bank asked to lend money under such circumstances as those in *Leuthold v. Fairchild,* even if it took time to examine all the records of the warehouse, could not be sure that those records were according to the fact. Another possible point of distinction is that in a grain-growing country the whole community regards it as very important that there should be facilities for obtaining advances upon grain shipped to the Chicago market, whereas there is in most communities a large number of persons who regard it as unwise to encourage facilities for trading in stocks and bonds on margin.

Note that in *Varney v. Curtis* the form of the transaction could easily have been changed so that C would have escaped liability. If B wishes to transfer his account from C to D, let him constitute D his agent to receive back from C the securities. If C delivers back to B personally, he is not a converter; if he delivers back to B, represented by an agent, he is not a converter. Should the law turn on whether or not the agency-form is used?

Is it not sensible to hold that whenever B bails to C, and the circumstances are such that C is not a converter if he delivers back to B, he should not become a converter because he delivers, not to B, but to D upon B's order?

If a court feels that where B, the rascal, stores goods with C, the bona fide warehouseman, C is not a converter if he delivers back to B, but is if he delivers to D upon B's order, then of course it will approve *Varney v. Curtis.* The learned judge who wrote the opinion in that case cited with approval *Hudmon v. DuBose* (p. 416), and did not mention the fact that there was a registered mortgage upon the property in question, which the Alabama court said was constructive notice to the warehouseman.

In attempting to decide the question whether the delivery by C to D on B's order should be treated as a conversion, although a delivery back to B is not, one should think first of storage and transportation cases, then of a case like *Leuthold v. Fairchild,* and then inquire, there being so many cases where it is sensible to

conclude that a delivery to B, and a delivery to D at B's order, should be treated alike, whether there is any substantial objection to having one simple rule that a delivery to B and a delivery at B's order shall be treated alike.

We submit that *Leuthold v. Fairchild* was well decided. If we were asked to name a case in this country on conversion distinguished both by a proper regard for the precedents and also for wisdom we should at once think of *Leuthold v. Fairchild*. The effect of any rule of law upon the business of the community must of course be considered, — it is the duty of judges to see to it that their rules work well for the community.

That being so, why, after all, was not Mr. Justice Brett right in *Hollins v. Fowler?* Why was it not very important to the Liverpool community that the business of cotton brokers should not be fraught with great risk? The answer is that, although Liverpool was a great cotton market, cotton was not an English product. It was very important to the Liverpool community that owners of cotton should feel safe in sending their cotton to Liverpool for sale. Any rule of law that substantially tended to block the rascals who got possession of cotton from turning it into money was a good rule, in the long run, for the Liverpool cotton business.

In his penetrating way, that very deep-thinking person, Mr. Justice Blackburn, observed that the legislature had not seen fit to make the Liverpool cotton market a market overt. A foreigner would think twice before sending his cotton to a place where if a rascal got hold of it he could give a good title to a bona fide purchaser. Would the cotton come? That was the question.

We doubt if any cotton brokers were deterred by the decision in *Hollins v. Fowler* from going on with their business. They must not take things in their stride as freely as they had; they were exposed to the risk of being converters if they bought for their principals from rascals, and delivered to their principals. But this would cause them not to give up the business, but to exercise great care in selecting persons from whom to buy. In the long run they would probably have more business under such a rule than without it.

APPENDIX F

Customer's Agreement

To ....

(Name of Firm Addressed)

....

(Address of Firm Addressed)

Gentlemen:

In consideration of your accepting one or more accounts of the undersigned (whether designated by name, number or otherwise) and your agreeing to act as brokers for the undersigned in the purchase or sale of securities or commodities, the undersigned agrees as follows:

1. All transactions under this agreement shall be subject to the constitution, rules, regulations, customs and usages of the exchange or market, and its clearing house, if any, where the transactions are executed by you or your agents, and, where applicable, to the provisions of the Securities Exchange Act of 1934, the Commodities Exchange Act, and present and future acts amendatory thereof and supplemental thereto, and the rules and regulations of the Federal Securities and Exchange Commission, the Board of Governors of the Federal Reserve System and of the Secretary of Agriculture in so far as they may be applicable.

2. Whenever any statute shall be enacted which shall affect in any manner or be inconsistent with any of the provisions hereof, or whenever any rule or regulation shall be prescribed or promulgated by the New York Stock Exchange, the Federal Securities and Exchange Commission, the Board of Governors of the Federal Reserve System and/or the Secretary of Agriculture which shall affect in any manner or be inconsistent with any of the provisions hereof, the provisions of this agreement so affected shall be deemed modified or superseded, as the case may be, by such statute rule or regulation, and all other provisions of the agreement and the provisions as so modified or superseded, shall in all respects continue and be in full force and effect.

3. Except as herein otherwise expressly provided, no provision

of this agreement shall in any respect be waived, altered, modified or amended unless such waiver, alteration, modification or amendment be committed to writing and signed by a member of your firm.

4. All monies, securities, commodities or other property which you may at any time be carrying for the undersigned or which may at any time be in your possession for any purpose, including safekeeping, shall be subject to a general lien for the discharge of all obligations of the undersigned to you, irrespective of whether or not you have made advances in connection with such securities, commodities or other property, and irrespective of the number of accounts the undersigned may have with you.

5. All securities and commodities or any other property, now or hereafter held by you, or carried by you for the undersigned, (either individually or jointly with others), or deposited to secure the same, may from time to time and without notice to me, be carried in your general loans and may be pledged, re-pledged, hypothecated or re-hypothecated, separately or in common with other securities and commodities or any other property, for the sum due to you thereon or for a greater sum and without retaining in your possession and control for delivery a like amount of similar securities or commodities.

6. Debit balances of the accounts of the undersigned shall be charged with interest, in accordance with your usual custom, and with any increases in rates caused by money market conditions, and with such other charges as you may make to cover your facilities and extra services.

7. You are hereby authorized, in your discretion, should the undersigned die or should you for any reason whatsoever deem it necessary for your protection, to sell any or all of the securities and commodities or other property which may be in your possession, or which you may be carrying for the undersigned (either individually or jointly with others), or to buy in any securities, commodities or other property of which the account or accounts of the undersigned may be short, or cancel any outstanding orders in order to close out the account or accounts of the undersigned in whole or in part or in order to close out any commitment made in behalf of the undersigned. Such sale, purchase or can-

cellation may be made according to your judgment and may be made, at your discretion, on the exchange or other market where such business is then usually transacted, or at public auction or at private sale, without advertising the same and without notice to the undersigned or to the personal representatives of the undersigned, and without prior tender, demand or call of any kind upon the undersigned or upon the personal representatives of the undersigned, and you may purchase the whole or any part thereof free from any right of redemption, and the undersigned shall remain liable for any deficiency; it being understood that a prior tender, demand or call of any kind from you, or prior notice from you, of the time and place of such sale or purchase shall not be considered a waiver of your right to sell or buy any securities and/or commodities and/or other property held by you, or owed you by the undersigned, at any time as hereinbefore provided.

8. The undersigned will at all times maintain margins for said accounts, as required by you from time to time.

9. The undersigned undertakes, at any time upon your demand, to discharge obligations of the undersigned to you, or, in the event of a closing of any account of the undersigned in whole or in part, to pay you the deficiency, if any, and no oral agreement or instructions to the contrary shall be recognized or enforceable.

10. In case of the sale of any security, commodity, or other property by you at the direction of the undersigned and your inability to deliver the same to the purchaser by reason of failure of the undersigned to supply you therewith, then and in such event, the undersigned authorizes you to borrow any security, commodity, or other property necessary to make delivery thereof, and the undersigned hereby agrees to be responsible for any loss which you may sustain thereby and any premiums which you may be required to pay thereon, and for any loss which you may sustain by reason of your inability to borrow the security, commodity, or other property sold.

11. At any time and from time to time, in your discretion, you may without notice to the undersigned, apply and/or transfer any or all monies, securities, commodities and/or other property of the undersigned interchangeably between any accounts of the undersigned (other than from Regulated Commodity Accounts).

12. It is understood and agreed that the undersigned, when placing with you any sell order for short account, will designate it as such and hereby authorizes you to mark such order as being "short," and when placing with you any order for long account, will designate it as such and hereby authorizes you to mark such order as being "long." Any sell order which the undersigned shall designate as being for long account as above provided, is for securities then owned by the undersigned and, if such securities are not then deliverable by you from any account of the undersigned, the placing of such order shall constitute a representation by the undersigned that it is impracticable for him then to deliver such securities to you but that he will deliver them as soon as it is possible for him to do so without undue inconvenience or expense.

13. In all transactions between you and the undersigned, the undersigned understands that you are acting as the brokers of the undersigned, except when you disclose to the undersigned in writing at or before the completion of a particular transaction that you are acting, with respect to such transaction, as dealers for your own account or as brokers for some other person.

14. Reports of the execution of orders and statements of the accounts of the undersigned shall be conclusive if not objected to in writing, the former within two days, and the latter within ten days, after forwarding by you to the undersigned by mail or otherwise.

15. Communications may be sent to the undersigned at the address of the undersigned given below, or at such other address as the undersigned may hereafter give you in writing, and all communications so sent, whether by mail, telegraph, messenger or otherwise, shall be deemed given to the undersigned personally, whether actually received or not.

16. Any controversy between you and the undersigned arising out of or relating to this contract or the breach thereof, shall be settled by arbitration, in accordance with the rules, then obtaining, of either the Arbitration Committee of the Chamber of Commerce of the State of New York, or the American Arbitration Association, or the Arbitration Committee of the New York Stock Exchange, as the undersigned may elect. If the undersigned does not make such election by registered mail addressed to you at your

main office within five (5) days after receipt of notification from you requesting such election, then the undersigned authorizes you to make such election in behalf of the undersigned. Any arbitration hereunder shall be before at least three arbitrators and the award of the arbitrators, or of a majority of them, shall be final, and judgment upon the award rendered may be entered in any court, state or federal, having jurisdiction.

17. This agreement and its enforcement shall be governed by the laws of the State of New York and its provisions shall be continuous; shall cover individually and collectively all accounts which the undersigned may open or re-open with you, and shall enure to the benefit of your present firm, and any successor firm or firms, irrespective of any change or changes at any time in the personnel thereof, for any cause whatsoever, and of the assigns of your present firm or any successor firm, and shall be binding upon the undersigned, and/or the estate, executors, administrators and assigns of the undersigned.

18. The undersigned represents that he is of full age; that no one except the undersigned has an interest in account or accounts of the undersigned with you; that the undersigned is not an employee of any exchange, or of any corporation of which any exchange owns a majority of the capital stock, or of a member of any exchange, or of a firm registered on any exchange, or of a bank, trust company, insurance company or of any corporation, firm or individual engaged in the business of dealing, either as broker or as principal, in securities, bills of exchange, acceptances or other forms of commercial paper.

Dated, ...

Customer

....

(City) (State) Address

Witness,

....

We hereby accept the account, and agree to act as brokers upon the terms and conditions hereinabove stated.

....

(Name of firm addressed)

By ....

APPENDIX G

Securities and Exchange Commission

WASHINGTON, NOVEMBER 15, 1940

SECURITIES EXCHANGE ACT OF 1934
Release No. 2690

The Securities and Exchange Commission today announced the adoption of two rules under the Securities Exchange Act of 1934 carrying out the statutory principles governing the pledging of customers' securities as collateral by members of national securities exchanges and other brokers and dealers.

The new rules are designed to furnish added protection to customers against losses which may result from brokerage failures. It has not previously been illegal under the usual kind of " customer's agreement " for a broker or dealer to commingle customers' securities with his own as collateral for loans used by the firm in its business as a dealer or trader for its own account. Likewise, it has not been illegal under such " customer's agreements " for brokers and dealers to borrow more on their customers' securities than was owed them by the customers. Where the broker or dealer failed under such circumstances, the risk of loss to customers was substantially increased.

To this end, the rules, in effect, prohibit brokers and dealers from risking the securities of their customers as collateral to finance their own trading, speculating or underwriting ventures.

Subject to certain exemptions, the rules put into operation three simple principles laid down in the three clauses of Section 8 (c) of the Act. The first is that brokers or dealers must not commingle the securities of different customers as collateral for a loan without the consent of each customer. Second, a broker or dealer must not commingle his customers' securities with his own under the same pledge. Finally, a broker or dealer must not pledge customers' securities for more than his customers owe him.

The rules were the subject of several months of discussion between the Commission's staff and the national securities exchanges, the National Association of Securities Dealers, Inc., cer-

tain banks making substantial brokers' loans and other representatives of the financial community. Many of the provisions of the rules are based upon suggestions made by these sources.

Because of the complexity of the credit mechanisms which these rules affect and because of the possibility that operation under the rules may entail some readjustments in the business methods of members, brokers and dealers, they will not become effective until February 17, 1941. The Commission suggests that brokers and dealers who will be subject to the new rules may find it desirable to conduct their businesses in accordance with these rules for some period prior to their effective date of February 17, 1941, in order that their operation may be studied and such readjustments made as may appear necessary before they become effective.

The two rules, designated as Rule X-8C-1 and Rule X-15C2-1, will provide uniformity of regulation with respect to all branches of the brokerage industry regardless of whether those subject to the rules are exchange members, or brokers or dealers doing a business through the medium of a member, or over-the-counter brokers or dealers who do not transact business through the medium of an exchange member. *Compliance with Rule X-8C-1 will thus automatically constitute compliance with Rule X-15C2-1, and vice versa.*

It is important to note the effect of paragraphs (a) (2) and (a) (3) of the rules upon the present practices of banks and other lenders in making and handling brokers' loans. Under the present type of loan agreement customarily used between a broker and a bank or other lender, the lender, of course, holds specific liens against the particular securities earmarked for each loan. In addition, the lender at present usually holds a general lien for the total amount of all of the broker's loans, some of which may represent borrowings on the broker's own securities to finance his own trading activities. This general lien runs against all of the securities deposited as collateral, even though customers' securities are included among them.

As may be seen, the danger in this practice of pledging all securities, including customers' securities, under a single lien is that if the firm gets into financial difficulties, the customers' securities

are in danger of facing the same loss as the firm's securities. Therefore, paragraph (a) (2) prohibits pledging customers' securities under such a general lien if the broker's or dealer's securities are also pledged under the same lien to obtain or increase the loan or as substituted collateral for customers' securities. Furthermore, the existence of such a general lien would result in a violation of paragraph (a) (3) of the rules if customers' securities are pledged thereunder for a sum greater than the total indebtedness of customers to the broker.

Accordingly, to avoid these violations it will be necessary for members, brokers or dealers to revise their agreements with banks and other lenders such as other brokers or dealers, who may obtain liens on customers' securities so that such lenders will not have liens involving violations of the rules. The Commission understands that a substantial time before the rules become effective, banks which customarily do a loan business with brokers and dealers will have made appropriate revisions in their loan agreements designed to permit brokers and dealers to meet the requirements of the rules.

Most of the exemptions which are embodied in the rules were necessitated by the difficulties which might be created by a strict, minute-to-minute application of the three basic principles of the rules to certain types of day-to-day financing of customers' transactions. Since these exemptions are somewhat technical and complex, the Commission is also making public a short explanation of the rules.

[Then follows the text of the Commission's action, which has been given at the opening of Chapter X.]

Summary of Rules X-8C-1 and X-15C2-1 under the Securities Exchange Act of 1934

Application of Rules

(*a*) *Rule X-8C-1*. This rule applies to all members of national securities exchanges, and to all brokers and dealers who transact a business in securities through the medium of any such member.

(*b*) *Rule X-15C2-1.* This rule applies to all brokers or dealers regardless of whether they are members of a national securities exchange or do a business in securities through the medium of such a member. The rule defines as " manipulative, deceptive or other fraudulent device or contrivance " any hypothecation of customers' securities except under the same circumstances as are specified by Rule X-8C-1.

Prohibitions of the Rules

Since the two rules, in effect, are identical in scope and text they will be discussed and explained together. Throughout this summary the term " broker " will be used to mean a member, broker or dealer. The rules contain three simple prohibitions which, generally speaking, coincide with the three clauses of Section 8 (c) of the Securities Exchange Act of 1934.

In effect, paragraph (a) of the rules provides that:

(1) A broker may not hypothecate securities carried for the account of his customers in such a way as to permit such securities to be commingled with securities of other customers unless he first obtains the written consent of each such customer;

(2) A broker may not hypothecate securities carried for the account of his customers under a lien for a loan made to the broker in such a way as will permit such securities to be commingled with securities of any person other than a bona fide customer; and

(3) A broker may not hypothecate securities carried for the account of his customers in such a way as to permit the liens of pledgees thereon to exceed the aggregate indebtedness of all such broker's customers in respect of securities carried for their accounts.

Definitions

For the purposes of these rules the term " customer " does not include general or special partners or directors or officers of the broker, as the case may be, but does include other members,

brokers or dealers. By excluding from the term "customer" any participant as such in any joint, group or syndicate account with a broker or any partner, officer or director of the broker, the rule permits the broker or any partner, director or officer thereof to participate with others in such accounts.

The term "securities carried for the account of customers" is defined by the rules to mean (1) securities received for the account of a customer; (2) securities sold, and earmarked or otherwise appropriated, to a customer; and (3) securities sold, but not appropriated, by a dealer to a customer who has made any payment on account, to the extent that the dealer owns and has received like securities. However, where securities are sold to a customer on a dealer basis, and where the securities are subject to a lien, they do not become "securities carried for the account of a customer" pending their release from such lien as promptly as practicable. Securities which are not "carried for the account of customers," of course, are not subject to the rules.

The rules provide that "aggregate indebtedness" of a broker's customers shall not be deemed to be reduced by reason of uncollected items. Thus, if the broker receives a check, part or all of the proceeds of which are to be credited to a customer, the "aggregate indebtedness" of customers is not reduced by the amount of the check until it has cleared. In the usual case, customers' debits are reduced or paid off by checks. Consequently, before such reductions in the "aggregate indebtedness" of customers actually occur, the broker will normally have a reasonable period of time between receipt of checks and their clearance in which he can reduce loans collateralized by customers' securities in order to prevent a violation of paragraph (a) (3) of the rules.

In computing the "aggregate indebtedness" of two accounts, one of which guarantees the other, they are to be treated as a single account and are to be considered on a consolidated basis. Furthermore, in the case of accounts in which both long and short positions are carried, the "aggregate indebtedness" of customers includes an amount equal to the market value of securities short in such accounts.

The rules also provide that in computing the total amount of

the liens to which customers' securities are subject, a broker or dealer may disregard any rehypothecation thereof by another broker who is also subject either to Rule X-8C-1 or Rule X-15C2-1.

Exemptions

Generally speaking, brokers should have no difficulty in complying with the requirement of paragraph (a) (3) that a broker must not pledge his customers' securities for a sum which, in the aggregate, is greater than the total amount that his customers owe to him on securities carried for their accounts. Good brokerage practice alone would make it desirable for a broker to borrow substantially less on customers' securities than customers owe him. There should thus be a " cushion " of his own capital between the amount of customers' debits and the amount of the broker's bank loans on customers' securities. This " cushion " should be sufficient in size to absorb any reasonably anticipated reductions in customers' indebtedness.

Nevertheless, in order to take care of the exceptional situation where customers' indebtedness is paid off in so great an amount as to use up this " cushion " and thus to reduce the total of customers' debit balances below the broker's current borrowings on customers' securities, this paragraph contains an exemption. The exemption provides that paragraph (a) (3) shall not be deemed to be violated if, as a result of *reductions* in the aggregate indebtedness of customers on any day, the amount of the liens to which customers' securities are subject during that day exceeds the total indebtedness of customers in respect of securities carried for their accounts. A payment by a customer on any day which reduces the amount which the customer would owe the broker on that day had the payment not been made is regarded as a reduction of indebtedness on that day within the meaning of the rules.

This exception is a limited one and is applicable only if funds sufficient to reduce the liens to which customers' securities are subject are paid or placed in transfer to pledgees so as to eliminate any temporarily exempted excess as promptly as practicable after the reduction occurs. The phrase " as promptly as practicable,"

as used in this exemption and in paragraph (b) (2) of the rules, means as soon as possible in the light of all the surrounding facts and circumstances, such as the size of the firm and its staff, the scope of its operations, the volume of business and the physical, practical and geographical limitations.

However, if it is not practicable to eliminate such an excess of liens over customers' indebtedness on the day upon which it arises, the rules require that funds sufficient to eliminate the excess must be paid or placed in transfer to pledgees either before one half hour after the commencement of banking hours on the next banking day at the place where the broker carries his largest principal amount of loans or before the broker obtains or increases any bank loan collateralized by customers' securities, whichever is earlier.

Exemption for Cash Accounts

Paragraph (c) of the rules affords a limited exemption from the requirement of paragraph (a) (1) that customers' securities may not be commingled under a loan unless all of the customers concerned have consented to such commingling. This exemption is applicable only to securities which are carried for a customer in a special cash account within the meaning of Section 4 (c) of Regulation T of the Board of Governors of the Federal Reserve System.

Generally speaking, such a special cash account is one in which the member, broker or dealer purchases securities for, or sells securities to, a customer only if funds sufficient for the purpose are already held in the customer's account or if the purchase or sale is effected in reliance upon an agreement, accepted in good faith, that the customer will promptly make full cash payment for the securities.

The exemption afforded by the rules for the commingling of customers' securities without their consent, where the securities are carried in such a special cash account, is subject to the condition that at or before the completion of the transaction of purchase of such securities for, or of sale of such securities to, the customer written notice is given or sent to him disclosing that the securities are or may be hypothecated under circumstances that will permit the commingling thereof with securities of other customers. The

term " the completion of the transaction " has the same meaning as is given to that term by Rule X-15C1-1 (b).

Exemption for Clearing House Liens.

Paragraph (d) of the rules exempts from the operation of paragraphs (a) (2), (a) (3) and certain other provisions any lien of a clearing corporation or similar department or association of a national securities exchange for a loan made and to be repaid on the same calendar day, if it is incidental to the clearing either of securities or of loans through the clearing house. Thus, for all practical purposes, the broker, in operating under paragraphs (a) (2) and (a) (3) of the rules, can disregard his pledges of customers' securities under clearing house liens. However, in computing " aggregate indebtedness " the broker must also disregard any indebtedness in respect of any securities which are subject to a clearing house lien exempted by this paragraph.

Exemption for Certain Liens on Securities of Non-customers

Paragraph (e) permits pledgees, whether banks or others, to have what may be referred to as a " one-way lien " against the broker's own securities. In discussing this exemption, brief reference must first be made to existing banking practices in the handling of brokers' loans. The usual type of loan agreement entered into between banks and borrowing brokers is designed to give the pledgee bank a lien upon *all* securities which the broker may place in the possession of the bank, for the full amount of *all* credit extended to the broker, even though some of such securities may be securities which the borrowing broker is carrying for the account of his customers. A broker's pledge of customers' securities under such circumstances to a bank, broker or other lender from which he is also borrowing funds collateralized by his own securities would, of course, violate paragraph (a) (2) because securities of customers would thus be commingled under a common lien with securities of persons other than bona fide customers. Paragraph (a) (3) might also be violated because customers' securities would thus be subjected to liens for a total amount equal to the sum of the broker's borrowings on customers' securities

and his borrowings on his own securities, which total might, of course, exceed the aggregate indebtedness of all customers to the broker.

The type of loan agreement heretofore in force between banks and borrowing brokers in some cases also provides that the bank may rehypothecate any collateral deposited by the broker, alone or with other property, for an amount greater than the broker's borrowings from the bank. The banks' right to effect such a rehypothecation would, of course, also involve a breach of paragraph (a) (2) and paragraph (a) (3) of the rules. Furthermore, any right of rehypothecation by a bank which would permit the commingling of the broker's own securities with those of his customers would, in any event, violate paragraph (a) (2).

Similarly, under the "day loan" agreements which have been in general use, the lending banks have obtained a lien upon all securities bought or otherwise acquired with the proceeds of the day loan. Under such an agreement, where a firm uses the proceeds of a day loan to take up securities for its own account as well as for the account of customers, it would be hypothecating their securities and his own securities under a single lien.

The same situation normally exists where a broker is carrying an account of his own and an omnibus account for his customers with a second broker. Any lien which the second broker carrying the accounts may have against customers' securities in the omnibus account to secure the first broker's debit balance in his own account would likewise involve a violation by the first broker of paragraph (a) (2) and, in some cases, of paragraph (a) (3) of the rules.

In order to avoid such violations of Rules X-8C-1 and X-15C2-1, brokers who pledge customers' securities with any pledgee from whom they are also borrowing on their own securities must see to it that the pledgee, whether it be a bank, another broker or any other lender, does not obtain a general or so-called "cross-lien" on customers' securities as additional collateral for other loans which it has made to the broker on his own securities or those of his partners on other non-customers. In other words, where a broker pledges customers' securities as well as his own securities

with a single pledgee to secure several loans, one or more of which are made against the broker's own securities, it will be necessary that the pledgee does not have a lien upon customers' securities for any loan except other loans also made against securities carried for the account of customers of the same broker.

It will also be necessary to see that the pledgee, unless he is a broker or dealer subject to Rule X-8C-1 or Rule X-15C2-1, does not have a right to rehypothecate customers' securities commingled with those of the broker or to rehypothecate customers' securities for a sum greater than the loans against those securities.

Furthermore, in situations where the broker will use the proceeds of a " day loan " to take up or otherwise acquire securities for his own account as well as for the account of customers, it will be necessary that, at any particular time, the lien of the pledgee under " day loans " upon securities of customers shall be no greater than that amount of the proceeds of the " day loans " as is then actually in use to acquire customers' securities, plus the amount of other loans (i.e., not " day loans ") collateralized in whole or in part by customers' securities. Such a limitation on the lien of the " day loan " would prevent not only the violation of paragraph (a) (2) which would otherwise result from commingling customers' securities with the firm's own securities under such a loan, but also possible violations of paragraph (a) (3) which might so result.

The Commission understands that a substantial time before the rules become effective, banks which customarily do a loan business with brokers and dealers will have made appropriate revisions in their general loan agreements as well as in their " day loan " agreements designed to permit brokers to meet the requirements of paragraphs (a) (2) and (a) (3) of the rules.

Although paragraph (a) (3) of the rules does prevent a pledgee from having a lien on customers' securities for loans made against the brokers' own securities, paragraph (e) of the rules permits the converse. That is, it permits what might be called a " one-way lien " against the broker's own securities as additional collateral for loans made against customers' securities. To this end the rules provide that the broker may use his own securities as

additional collateral for day loans and for loans which are "made against securities carried for the account of customers." For the purposes of this exemption, such a loan is defined as a loan which is obtained or increased *only* on the basis of securities carried for the account of customers. Furthermore, this exemption is applicable only if the pledgee agrees that securities which it is informed are carried for the account of customers will be physically segregated from any other securities. The exception does not permit the broker to deposit his own securities as collateral in substitution for customers' securities.

Notice Requirements

Finally, paragraph (f) of Rule X-8C-1 provides that no person subject to its provisions shall hypothecate any securities of a customer unless at or prior to the hypothecation he gives written notice to the pledgee that the security pledged is carried for the account of a customer and that the hypothecation does not contravene the rule. However, in the case of an omnibus account, where written notice to the broker carrying the account may not be practicable before each transaction which results in a pledging of the securities bought for the account, the member, broker or dealer for whom the account is carried need only furnish a signed statement to the broker carrying the omnibus account that all securities in such account will be customers' securities and that the hypothecations will not contravene the rule. Day loans which are made and to be repaid on the same calendar day are exempted from these requirements for the giving of notice to pledgees.

APPENDIX H

Questions and Answers

The author has looked through old examination papers and has based the following ten questions upon some questions found therein. The answers express the author's views as to what is, or at least ought to be, the law. Question No. X is very difficult (every examination paper ought to have one, but only one, so difficult a question) and as to that question, the author desires to say that his mind is not at peace and that the answer given only represents what, at the moment, he is inclined to believe that the law ought to be.

Question No. I. A owned a chattel and bailed it to B for six months. Before those six months had expired, C tortiously seized the chattel. At the time of the seizure the fair market value of the chattel was \$1,000, B's interest therein being worth \$100 and A's interest therein being worth \$900. What actions can be maintained by A or B and what amount of damages can be recovered?

Answer: (1) Assume that we are in a jurisdiction which follows *Gordon v. Harper* (p. 152) and the *doctrine* of *The Winkfield* case (p. 150). Then A cannot maintain trover, but can (unless B has sued C) maintain case. In an action on the case he would recover \$900, the value of his interest. He is not allowed to recover \$1,000, making himself accountable to B for \$100; he recovers part damages commensurate with his part ownership.

On the other hand B, the part owner in possession, may maintain trover and recover \$1,000, making himself accountable to A for \$900. The dog cannot wag the tail but the tail can wag the dog. This is not sensible, and is explicable only as a survival of Plantagenet conceptions under which possessory rights were patrician, and non-possessory rights were plebeian. It is as useful in modern law as is an appendix in the human body.

If B recovers \$1,000, and C pays B, that bars A from any re-

lief against C, even if B has absconded, or is financially irresponsible. Moreover, even if A had prior to C's payment to B had an action pending against C, C could plead the satisfaction of B's judgment in bar of A's claim.

If A recovers $900 in case, and C satisfies that judgment, A's bailor interest is thereby by operation of law transferred from A to C. Therefore, if B sues C, the case is on all fours with a case where A bails to B, A converts (as by a premature taking), and B brings trover. In such case B recovers only the value of his bailee's interest (p. 210, note 34). He could therefore only recover $100 against C, the successor to A's bailor's interest. Even if B had a suit pending against C, prior to C's payment to A, C could plead the satisfaction of A's judgment in order to mitigate damages.

(2) Assume that we are in a jurisdiction which follows Story's lead (p. 155). Then either A or B may sue and recover $1,000. After one or the other obtained judgment, the other's right to sue ceased. In a word, either the part owner in possession or the part owner out of possession would be allowed to recover whole damages, being accountable for that fraction of the proceeds which exceeded his own fractional interest to the other part owner.

(3) Assume that we are in a jurisdiction which has modern procedural facilities for solving three-party problems by a three-party machinery (p. 152). If either A or B desires to sue, he must make the other a party, and the court will then decree (a) how much C should pay, and (b) in what proportions A and B should take.

Even in such a jurisdiction, however, A or B might properly be allowed to sue *alone*, if on the facts the assent of the other to such a course might fairly be presumed. Thus on the facts of *The Winkfield*, the assent of the various letter writers that the Governmant should control the litigation and collect the whole value (subject to accountability) may fairly be presumed, and, without doubt, the court in that case reached the right *result*. Similarly, there might well be cases where the assent of the bailee that the bailor should control the litigation and collect the whole (subject

to accountability) may fairly be presumed. *But,* except where there are such facts, such cases are *three*-party problems and therefore a three-party machinery, where available, should be used. In jurisdictions where it is not yet available, the legislature should pass the necessary legislation.

It is curious to observe that many jurists of the present day are fascinated by the *Winkfield doctrine.* They think it is progressive. Not at all. It is just a throwback to judges whose bodies have been amouldering in the ground for over five hundred years, but whose conceptions (which may well have been suited to conditions existing in their day) go marching on, ruthlessly trampling down the modern children of common sense.

Question No. II. A lent his automobile to B for a week end. B took it to a hotel operated by C and stayed at the hotel for a month incurring a bill for \$500. By statute C might, on complying with certain conditions, make a liquidating sale of the baggage of guests or of the cars of guests garaged with it, upon default by the guest. C made a sale, without complying with all the statutory conditions, and delivered the automobile to the purchaser. The sale was fairly conducted and the automobile sold for \$800 which was its fair market value. A sued C for the conversion of the automobile. C paid \$300 into court and pleaded the \$500 debt of B both as a defense and as a counterclaim. What judgment?

Answer: Judgment for A for \$800, with interest.

Assuming that C obtained a lien, nevertheless his delivery pursuant to an unauthorized sale was a conversion. If a person having a statutory lien similar to a common law lien (p. 13) converts the property, the conversion annihilates the right *in rem,* and therefore A was entitled to \$800 (the money paid into court, and \$500 more). C's conversion of the security did not forfeit the debt, the right *in personam,* but that right was against B, not A, and is therefore neither a defense nor a basis for a counterclaim by C against A.

Question No. III. B opened a margin account with C, a stockbroker, and pledged registered bonds, with forged indorsements. C believed, and reasonably believed, that the indorsements were

genuine and that B was the owner. B complained of the manner in which C executed orders, and C requested him to take up his securities. B arranged with D to take over the account, and directed C to deliver to D all securities purchased for him and the bonds which had been deposited as margin upon receiving from D payment of B's debt to C. C did as directed. A seeks to hold C as a converter. What judgment?

Answer: Judgment for C.

At one time if a defendant had taken property into his possession without the authority of the owner and had in good faith claimed to have a pledge interest therein, he was, without more, a converter. But the English law on that was changed by *Spackman v. Foster*, L. R. 11 Q. B. D. 99 (1883), and the American law is pretty surely in accord with *Spackman v. Foster*. Therefore, B was not guilty of a 6 (a) species of conversion (p. 118).

Now, the general rule certainly is that any tortious transfer of the possession — any setting of the plaintiff's property afloat on a sea of persons, strangers to him, so that the plaintiff is obliged to go and chase it — is a conversion (third species, p. 118). There are a few exceptions to this. The question is, therefore, whether an exception should be made on the facts of this case.

If C had returned the bonds to B it is clear on the authorities that C would not have been a converter. Where the property of A gets into the hands of B, and B bails to C, and later C either delivers the property back to B, *or* delivers it, at the order of B, to D, a third party, and C has acted in good faith and with due care, the law ought to be that C is not a converter. To hold C liable as a converter is to give a scope to the doctrine of liability without fault unjustified by any public need.

The thoughts of the author are contrary to the thoughts of the court in *Varney v. Curtis*, 213 Mass. 309, 315, 100 N. E. 650, L. R. A. 1916A 629, Ann. Cas. 1914A 340 (1913), but they are in substantial harmony with some thoughts by those excellent judges, Mr. Justice Mitchell (see *Leuthold v. Fairchild*, pp. 419, 420), and Mr. Justice Blackburn (see *Hollins v. Fowler*, pp. 419–422).

Question No. IV. A borrowed from B on the security of some shares of stock, the debt to be repaid in six months. A disappeared, but two years later reappeared, tendered to B the full amount of his debt with interest, and demanded the shares. B honestly believed that A by his delay had forfeited his rights, and refused to deliver. He did not qualify his refusal. As soon as A had gone, B consulted his attorney, and, on his advice, rushed after A and offered to accept the tender and surrender the shares. A refused to make the tender a second time. May A maintain replevin? May A maintain tort for conversion?

Answer: "No," to both questions. True it is, that a tortious withholding (the second species of conversion) by a pledgee annihilates his right *in rem* today just as it has always done. The modern law on this point is unchanged from the pre-1863 law (p. 184). Therefore, if there had been a conversion, replevin would have lain.

B's act, however, should not be held to be a conversion. True it is, that he did in the first instance make an absolute refusal, and that such refusal was unjustifiable. And rarely, very rarely, will an unjustifiable refusal be excusable. But this is one of the rare cases where it should be excused. B slipped, but A had greased the way. A had defaulted. There is a rather widespread belief that a default (if, at least, not cured within what may perhaps be called "pawnbrokers' days of grace,") makes the pledgee the absolute owner (although this has never been the law, not even in Glanville's time). B was impulsive, but his footwork was good and no harm was done to A. Under such circumstances it is not unduly loose for a court to regard the first impulsive refusal and the slightly later rectification as parts of one transaction.

See *McCalla v. Clark* (pp. 179–183).

Question No. V. Contrast *M'Combie v. Davies* (p. 190) with *Donald v. Suckling* (p. 204).

Answer: In *M'Combie v. Davies,* B was a factor, having a lien by usage (p. 14) on the tobacco of A for £30. B pledged the tobacco to C for a larger amount. This was a double-headed conversion by B, — a tortious transfer (third species) and a claim

of ownership (sixth, a, species). It was held that this conversion annihilated the right *in rem,* that C took nothing but the possession, and that therefore when A demanded the goods from C, without making any tender whatever, and C absolutely refused to surrender, C had tortiously withheld and was therefore guilty of the second species of conversion.

In *Donald v. Suckling,* B was not a factor (and therefore the Factors' Acts which had been passed by Parliament at the insistence of the merchants, p. 14, had no application). A had pledged some debentures to B. These debentures were treated by the court as second-class securities (p. 204). B had pledged them to C for a debt of his own which, almost surely (see p. 205) was for a larger amount than the A, B debt. This was held *not* to annihilate the right *in rem.* Therefore A could not maintain detinue without making a tender of the amount due to the proper person. (The judges did not commit themselves as to whether B or C was the proper person, but in *Talty v. Freedman's Trust Co.,* p. 207, the thought of the court pretty surely was that the tender should be made to C.)

The two cases are indistinguishable except that in *M'Combie v. Davies* B was a lienee and that in *Donald v. Suckling* B was a pledgee. The law has continued to this day to draw the line at this place. A tortious transfer by any lienee annihilates the right *in rem,* but a tortious transfer of second-class security by a pledgee does not annihilate the right *in rem.*

This is very important. The modern law of pledge started in 1863 with *Johnson v. Stear* (p. 196) where there had been a tortious transfer of the possession by a delivery made pursuant to a slightly premature liquidating sale. The debtor-pledgor was bankrupt. Therefore, if the right *in rem* had been forfeited, and consequently the creditor had been turned from a secured creditor into an unsecured creditor, the creditor would have suffered greatly. The court winced at imposing this consequence upon a blunderer. That started the no-forfeiture-of-the-right-*in-rem* thought which is the pith of the modern law of pledge. Now, in *Donald v. Suckling* one judge thought the lead of *M'Combie v. Davies* ought to be followed, but three judges thought the lead of *Johnson v. Stear* ought to be followed. A moment's reflection will

show that the court was now being influenced, not by the thought of saving a blundering B from loss, but by the thought of saving from loss a bona fide purchaser or pledgee from B.

The modern law of pledge has, therefore, two parts. The first part saves B, the pledgee himself, from the consequences of an annihilation of the right *in rem*. The second part saves C, the bona fide transferee of B, from such consequences; and, as the law has developed, it saves C even if B himself is an out-and-out rascal (see *Talty v. Freedman's Trust Co.*, (p. 207).

Question No. VI. A bought through B, a stockbroker, certain shares of stock at a cost of $10,000. A paid B $1,000 on account, and agreed to make further payments on account, if necessary, so that at no time should the amount remaining due be more than 90 per cent of the market price of the shares, and further agreed that, in default of such further payments, B might sell the shares without notice to him. The shares fell so that their market price was $9,500. B demanded a further payment, and A made a further payment of $1,000 but, through an error of one of B's clerks, A was not credited with the payment. B sold the shares without prior notice to A, for $9,200, and sent notice to A that the sale had been made. The shares rose within three days after the sale had been made so that their market price was $9,700, and then steadily declined. A brought suit against B for the conversion of the shares, and at the time suit was brought their market price was $8,500. How much (disregarding interest and commissions) should A recover from B?

Answer: $1,700.

The relation between A and B was that of pledgor and pledgee. The sale was unauthorized and the delivery pursuant thereto was a conversion of the pledgor's interest. The stock should be valued at $9,700 (there was no spread here between conversion and notice thereof; and "a reasonable time" would be at least three days). A's debt was $8,000. Therefore damages were $1,700.

Authorities accord are very numerous. Almost all courts today take it in their stride that a pledgee may convert the pledgor's interest, just as it is clear, and has long been clear, that a pledgor,

or any other bailor, may convert the pledgee's, or any other bailee's, interest. See note 34 on p. 210.

A is a part owner out of possession. He is not seeking whole damages but only part damages, — damages commensurate with his interest. Even Massachusetts allows a plaintiff to recover in "tort for conversion" where a pledgee makes delivery pursuant to an unauthorized sale. *Boston Terminal Refrigerating* case, p. 163.

The case at bar is *not* like *Gordon v. Harper* (p. 52). That case was an A, C case; a part owner out of possession sought whole damages. The case at bar is an A, B case. The part owner seeks only part damages, — damages commensurate with, and limited by, his part ownership.

The fact that A does not have the right to the immediate possession at the conclusion of the act complained of does not block A from maintaining tort for conversion.

That is now established by the great weight of authority. Yet once in a while the *Gordon v. Harper* poison still affects the mind of some judge who is either not an adequate judge, or is an adequate judge who is not, for the moment, functioning (pp. 152–159, 333, 347, 385).

Question No. VII. A was a margin customer of B, a stockbroker. B pledged the stock bought for A's account as part of the collateral for a loan from C to B of a larger amount than A's debt to B. C was a bona fide pledgee. B did not retain under his control other like securities of like amount. A did not consent to such repledge. The market price of A's stock at the time of the repledge was $10,000, and A's debt to B was $9,000. Within fifteen days thereafter the market price was $11,000, but at all later times was less than $11,000. A sued B in tort for conversion. What judgment?

Answer: Judgment for A for $2,000 with interest at the legal rate from the time of the repledge.

In question No. VI we saw that a tortious transfer by way of sale is clearly a conversion. A tortious transfer by way of pledge is also a conversion.

The stock was first-class security (p. 22). C had independent rights. Therefore, if B defaulted to C, C might lawfully make a liquidating sale which would destroy A's title to the stock. This putting A's title in jeopardy of destruction was a *major,* serious tort and not merely a minor, trifling tort (p. 233).

Moreover, the repledge involved a separation by B of the security from the debt, and at least most courts have regarded it as axiomatic that separation of security from debt is a conversion of the security.

Moreover, to hold that the tortious repledge was not a conversion is out of joint with the law as to conversions by "ordinary" brokers (p. 127).

Moreover, this is also contrary to both common sense and common honesty, there being a difference in degree but not in kind from "borrowing" by fiduciaries in the strict sense of that term of funds under their control as fiduciaries (p. 231).

Moreover, the thought that such a wrongful act is in substance only a breach of contract undermines the fundamental principle in the law of margin customers, which is that such customers have *property* rights as well as contract rights (p. 229). Such undermining naturally leads to some of the amazing results reached in Massachusetts (pp. 379–387).

The fact that only a ten per cent margin was required shows that the transaction occurred in the old days (p. 223). Today such a transaction would clearly be a conversion by force of the S.E.C. rules of February 24, 1941 (pp. 367–368).

Moreover, today, if such transaction was in New York, Section 956 of the Penal Code would give additional reason for denouncing the tortious pledge as a conversion and not a mere "technical" conversion (p. 335, note 1).

The *Baker v. Drake* rule as to measure of damages (p. 265), should apply to conversions by tortious transfers by way of pledge as well as to tortious transfers by way of sale.

Question No. VIII. Same facts as in question No. VII, except that B's memorandum of purchase which B sent to A and which A received had printed upon it: "It is agreed that B may re-

pledge stock purchased as part of collateral for his bank loans." Does this change the result?

Answer: Not necessarily. It does, however, introduce a new element in that it should be left to the jury to find whether or no A gave a *conscious, intelligent* consent to such a repledge as was made. But unless A did give a conscious, intelligent consent, the result is precisely the same as in Question VIII (p. 358, point 3).

Question No. IX. A borrowed $5,000 from B, on a non-negotiable demand note, with jewels worth $10,000 as security. On the facts the doctrine of possession, *plus,* (p. 25), did not apply. B sold and delivered the jewels to D, a bona fide purchaser. Later, B indorsed and delivered A's note to C, another bona fide purchaser. C brought a proceeding in equity against A, B and D. What decree?

Answer: If, but only if, A consents, A must pay C $5,000 and, as part of the same transaction, D must surrender the jewels to A.

When B sold the jewels to D he converted them. If B had kept the note and sued A upon it, A would have had a counterclaim against B (probably, but not necessarily, for an amount greater than the amount of A's debt to B). The note of A to B was a second-class debt (p. 22), but, although not negotiable, it was *assignable* at law before default (Chapter IV). Since it was not negotiable, C took the legal title *cum onere* debt-spavins (pp. 73, 74); the extent of C's rights was reduced by any defense or any counterclaim which A had against B at the time of B's transfer to C. Therefore, in an action by C against A, A could counterclaim for the conversion by B, and C could recover against A no larger amount than B could have recovered.

Therefore A may, if he sees fit, sit tight. C cannot make him part with cash (except to the extent, if any, that the debt exceeds conversion damages). But, if A consents, let there be a decree under which, as parts of one transaction, (a) A must pay C and (b) D must surrender the jewels to A without receiving a cent.

As between C and D, C is the proper person to receive the payment of the debt. He bought the primary, principal thing and D

bought only the secondary, supporting thing (p. 17). Even if C obtained only an equity it may well be urged that C's equity, although subsequent, is superior (p. 85). But C's position is stronger than that. The non-negotiable note was before default assignable *at law* and not merely in equity (Chapter IV).

Therefore, C prevails over D on the familiar principle that the bona fide purchaser of a legal title takes that title free of antedating, cumbering equities (p. 90).

Therefore, when C, the right man to be paid, is paid, the pledge interest evaporates, for it is clear law that whatever extinguishes the debt extinguishes the pledge (p. 17).

But A may block this solution if he desires to do so. It is for A to call the tune. Probably, the jewels will be worth substantially more than the debt, and A will be glad to assent to such a decree.

Question No. X. A owned certain jewels. She applied to B, who had been her friend for many years, for a loan upon the jewels, and left the jewels with B so that they might be appraised. B thereupon borrowed $10,000 from D, and gave a negotiable promissory note for $10,000, and pledged the jewels to secure payment of the note. D was a bona fide pledgee.

Then B handed A a check for $5,000, and A gave to B a paper-writing in the words and figures following: "To B. I. O. U. $5,000. A."

Then B borrowed $3,000 from C, the loan being evidenced by a negotiable promissory note payable on demand to the order of C for $3,000. B wrote his name on the back of the I. O. U. received from A and delivered it to C, to secure B's note to C. C was a bona fide pledgee.

C pressed A for a payment, and she paid him $2,000 on account. B assured her that the jewels were in B's possession, and that it was quite all right for her to pay the $2,000 to C, and A believed him.

Then D informed A that he was in possession of the jewels and that he had a $10,000 interest therein, and forbade her to pay to anyone else any part of the money payable by her. Nevertheless,

C pressed A so hard, threatening suit, that to appease him A paid C $1,500 more.

Then D delivered the $10,000 note (B to D) before its maturity to E, a bona fide purchaser. E knew nothing about the jewels. Then D delivered the jewels to F, a bona fide purchaser.

Then A brought a suit in equity against B, C, D, E, and F, served them all, and obtained a preliminary injunction restraining F from transferring the possession of the jewels. She asked the court to decree that F should surrender the jewels to her on the payment by her of such sum or sums of money to such person or persons as the court might designate. E answered, asking the court to decree that A should pay E $10,000, or for such other relief as the court might think fitting. F answered, asking the court to decree that he was the owner of the jewels, or for such other relief as the court might think fitting. B, C and D filed no answers. What decree ought the court to enter?

Answer: (a) As parts of one transaction, A must pay F $2,000, and F must surrender the jewels to A. (b) D must pay to E the amount due on the B, D note and must also pay F the value of the jewels, less $2,000. (c) C must pay A $500. (Interest due on the B, C debt has been disregarded in both (a) and (c).)

When B pledged the jewels to D, B did not have a pledge interest therein, but D should be entitled to as much protection as if B had had a pledge right, since this will not expose A to any consequence other than what she had expected (see p. 209). D therefore acquired an equity for $5,000 in the A, B debt (see answer to Question IX).

But C's right was a legal right and, so far as the $3,000 debt from B to C is concerned, C wins over D.

Moreover, where a promise to pay money is not sold, but pledged, by the creditor (to a creditor of the creditor), the pledgee by a rule of the common law may, at least as a general rule, collect the whole amount from the debtor and give him a valid discharge therefor, (the pledgee-creditor of course becoming accountable to the pledgor-debtor for any surplus). If, therefore, there had been no D, E, or F, A would have obtained by her payment

to C a valid discharge to the extent of \$3,500 against B. But when D gave notice to A of his claim, A should have interpleaded B, C and D, and paid the remaining \$3,000 into court. But she did not do so, and the payment of \$500 (out of the second payment) was paid to a person not entitled in equity thereto.

Therefore A remains liable to pay \$2,000 to either D, E, or F. It is plain that D should not prevail over E or F. The crucial question therefore is whether E or F has the superior claim to the \$2,000.

As between E and F, F wins. There is only a superficial similarity between the C, D struggle (question IX) and the E, F struggle. C thought he was getting A's debt to B, and, if C is not declared to be the person to whom A must pay, C is disappointed in his expectations. But E thought he was getting, not A's debt to B, but B's debt to D. And he did get it. Therefore, if E is preferred to F, E will get something in the nature of a security for the B, D debt which he had not expected to have, — the court will not be saving him from disappointment but will be giving him a happy surprise and will be telling him that he has an unexpected buttress to his position.

On the other hand, F supposed that he was getting the legal title to the jewels and is grievously disappointed at finding that D, his vendor, had no title. Therefore, the court should partially console him by treating him as the successor to D's equity in the A, B debt.

E and F are both good men. The court seeks for some rational basis for preference, and it is sensible to consider the expectations which E and F respectively had, and partially to console F rather than to give E a happy surprise.

A minor, but additional, argument for holding F to be entitled is that the equity in A's debt to B was generated in D through D's acquiring the possession of the jewels in good faith and for value, and that therefore F is a natural successor to D's equity because F has in turn acquired the possession of the jewels in good faith and for value.

Therefore the most important part of the decree should be that

as parts of one transaction (a) A should pay F $2,000, and (b) F should surrender the jewels to A. A has asked for relief on these lines.

Of course E should be held entitled to receive from D the amount of D's note, and F should be entitled to receive from D the value of the jewels at the time of F's surrender to A, less $2,000.

One point remains to be considered. Should C be required to pay $500 to A? On principle, yes. But it is to be noted that there is important authority that may fairly be cited against this, on the ground that A voluntarily made the payment, under the influence of a mistake of law as to what A's duty was.

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Even if well decided, it is not authority that a pledgor may not maintain an action for a conversion against the pledgee. In *Gordon v. Harper,* A bailed to B and C converted. Held, A could not recover *whole* damages against C, a third person (making himself accountable to B for B's share). But when A sues B for B's conversion of A's pledgor interest, A is asking only *part* damages. A few, but only a few, courts have confused the A, C case with the A, B case, 164, 331–334, 343, 345, 385
Therefore damages for conversion of a pledgor's interest are the value of the property in question, less the debt. As to the method of valuing the property there has been, and is, diversity in the decisions. The rule as announced in *Baker v. Drake,* 265, 268, is the best rule which has yet been announced. It is definitely superior to the *Salmon Weed* rule, which may allow a converter to purchase at a panic price, without giving the customer any advantage of a rebound price, 268–273, 348–351

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